

Developing the Desert: A Case Study of Israeli Infrastructure Privatization

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ABSTRACT

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In the face of mounting hyperinflation in the 1970s and 1980s, Israel underwent a stabilization program focused on reducing the size of its public sector. The principles of the program, influenced heavily by neoliberal thinking, were a radical shift away from the collectivist ethos Israel had been built on. This paper focuses on the impact of the ensuing privatization of infrastructure-related state assets. Given the primacy of these assets to the public's standard of living, infrastructure is of particular interest to any government. As Israel moved away from state ownership, it involved the private sector to various degrees. In telecommunications, the privatization of government company *Bezeq* was imperfectly executed, resulting in economic concentration that mirrors wealth inequality found in other parts of Israeli society. In water, Israel utilized more limited forms of privatization to greater success. The national water carrier, *Mekorot*, operates as a government company, but may sell a minority stake. Doing so would provide liquidity while maintaining the state's decision-making authority over a scarce resource. Similarly, the use of public-private partnerships in major desalination plants has balanced the risk between the public and private sectors, tapping into private sector expertise while guaranteeing sustainable water output. The three cases studied demonstrate different approaches to economic liberalization in essential assets. For the most part, Israel's modes of privatization, at least in infrastructure, have reduced the state's burden while maintaining the public interest.

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Introduction

The fact that infrastructure investment is often referred to as “nation-building” speaks to its significance. The roads, bridges, water systems, and telecommunication networks that most citizens of developed countries take for granted play a fundamental role in shaping economic development and quality of life. In building and maintaining these critical assets, governments take on immense responsibility and commensurate risk. Still, it is not obvious that governments should shoulder these responsibilities and risks entirely on their own. Many countries have employed the private sector to various degrees, transferring portions of economic risk to private enterprises.

For private investors, core infrastructure, defined as “assets for which the cash flows to equity owners is forecastable with a low margin of error” have a growing appeal.¹ These essential assets hold the appeal of stable, reliable cash flows. More so than other real assets like real estate or commodities, infrastructure assets are vital regardless of the larger economic environment, providing investors with low volatility in the face of an economic downturn. Infrastructure sectors, including transportation, communications, electricity, energy, and water and sewage, service needs that persist regardless of the closing price of the S&P 500. In a recession, consumers cut spending in many areas, but generally they do not turn off electricity to their stoves or stop using telecom services to communicate. Moreover, the current low-interest rate environment, intensified by central bank cuts in response to the coronavirus pandemic, has made debt cheaper, potentially allowing investors to secure low financing rates for long-term infrastructure projects. The influx of private capital towards this asset class is particularly timely

¹ JP Morgan Asset Management. *Infrastructure Investing: Key Benefits and Risks*. 2015.
<https://am.jpmorgan.com/blobcontent/1383271579721/83456/Infrastructure-Investing-Key-benefits-and-risks.pdf>.

as governments worldwide look to reinvest in their national infrastructure to the tune of \$57 trillion over the next fifteen years.²

Still, determining the appropriate role of private capital in national infrastructure is not an easy task. In studying how governments shape policy to maintain public interest while privatizing, the case of Israel is particularly interesting. It tells the story of a nation built on social-democratic values that transitioned to a free enterprise system with the global wave of neoliberalism following the end of the Cold War. As it opened its economy and reduced the role of the public sector, Israel introduced the private sector to its core infrastructure sectors in a variety of forms. This paper studies three of those forms: a full privatization in the case of telecommunications, a potential minority privatization of the national water company, and public-private partnerships in the development of desalination plants.

² Palter, Robert, and Pohl Herbert. "Money Isn't Everything (but We Need \$57 Trillion for Infrastructure)." McKinsey & Company . Last modified December 2014. [https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/money-isnt-everything-but-we-need-\\$57-trillion-for-infrastructure](https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/money-isnt-everything-but-we-need-$57-trillion-for-infrastructure).

A New World Order

The Cold War and ideological victor

In a broad sense, the Cold War was an ideological fight between liberal democracy and capitalism on one hand and Marxism-Leninism and centralization on the other. From the Nixon-Khrushchev “kitchen debate” to proxy wars fought globally, the fundamental question loomed large: which system would prevail? The end of the Cold War answered that question. With the fall of the USSR, two alternatives for structuring society turned into one. The zeitgeist of the political moment was perhaps best captured by Francis Fukuyama in his seminal essay, “The End of History?”. In it, he argues that liberalism overcame two major challenges: fascism in World War II and communism in the Cold War. He takes the fact that there was neither an elimination of ideology nor a merger of ideologies to claim “victory of economic and political liberalism”.³ The essay notes that these ideas are compatible but not guaranteed—it is not obvious that economic liberalism will lead to political liberalism. Indeed, the application of economic liberalism without democratic structures in the Middle East and Africa soon led to crony capitalism. Taken together, however, Fukuyama asserted that this brand of western liberal democracy was the ultimate destiny of humanity.

This idea was echoed by the major international economic institutions of the day. Without the USSR as an ideological counter, the neoliberal organizations established after World War II became hegemonic. Both the International Monetary Fund and the World Bank were born out of the Bretton Woods conference in 1944. Initially, the IMF was meant to regulate exchange rates and facilitate trade, while the World Bank was supposed to lend to Western European

³ Fukuyama, Francis. "The End of History?" *The National Interest*, no. 16 (1989): 3-18.
<http://www.jstor.org.ezproxy.lib.utexas.edu/stable/24027184>.

government to rebuild after the war. The missions of both organizations gradually evolved to include global economic development. Given that voting power is determined by capital contribution to each organization, both organizations have come to be dominated by the Group of Seven (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States).⁴

As tensions rose between the United States and the USSR, both sides used foreign aid as a strategic tool, either extending aid to form alliances or withholding it to punish undesirable actions.⁵ Following the Cold War, when they could no longer leverage the political animosity between the Americans and Soviets for economic aid, developing nations had only one option: turn to the United States and/or the international institutions dominated by neoliberal ideology.

While neoliberalism is an amorphous term, it has discernible economic goals: free markets, free trade, and the proliferation of private enterprise in the name of increasing consumer choice.⁶ When applied to development, the IMF conceptualized neoliberalism along two major ideas: (1) increased competition and (2) a smaller role for the state.⁷ In practice, the IMF and World Bank used their funds to guide international development along the lines of their vision of a neoliberal future. The IMF in particular extended loans to countries in economic distress with strict caveats. Through these ‘Structural Adjustment Programs’, the IMF required loan recipients to restructure their economies along specific lines: deregulation and the opening of domestic markets to increase competition and privatization and austerity to limit the role of government.⁸ The World Bank operated under a similar framework, extending development loans for specific

⁴ *The Thistle*. "The IMF and the WORLD BANK: Puppets of the Neoliberal Onslaught." September 26, 2000. <https://www.mit.edu/~thistle/v13/2/imf.html>.

⁵ Williams, Victoria. "Foreign Aid." In *Britannica*. <https://www.britannica.com/topic/foreign-aid>.

⁶ *The Thistle*. "The IMF and the WORLD BANK"

⁷ Ostry, Jonathan D., Prakash Loungani, and Davide Furceri. "Neoliberalism: Oversold?" *Finance and Development* 53, no. 2 (June 2016). <https://www.imf.org/external/pubs/ft/fandd/2016/06/ostry.htm>.

⁸ *Ibid.*

projects that it deemed critical for economic growth. If a country refused to abide by these criteria, it would be hard pressed to find an alternative: private lenders generally looked to the IMF's actions in their due diligence.⁹ For most of the world, embracing neoliberalism was the most viable path forward.

In this larger context, Israel found itself facing a spiral of inflation in the late 1970s. Still, it was not obvious that Israel would readily adopt neoliberalism. Even before statehood, the community that would form Israel was deeply collectivist. Cultural legacies and the realities of war had only deepened a collectivist ethic and grown the reach of the state.

Israel: A history of collectivism

Israel was founded as the national homeland of the Jewish people on the principle that Jews could not live safe, normal lives as minorities in other societies. The guiding principles of the Zionist movement, which spearheaded early Jewish settlement in mandatory Palestine and became a prominent ideological force in the founding of the state, were necessarily collectivist. These ideas around the preservation of the community and the necessity of organizing centrally defined early policy and remained pervasive after statehood in 1948.

Although anti-Semitism had been prevalent in Europe for centuries, the nineteenth century brought particular violence. Russian *pogroms*, organized massacres of Jews, in 1881-1882 had already driven refugees to then-Ottoman controlled Palestine. This first *aliyah*, or

⁹ *The Thistle*. "The IMF and the WORLD BANK"

wave of immigration, brought around 35,000 Jews to Palestine, prior to the existence of an organized Zionist movement.¹⁰

While ideas of Jewish sovereignty in the face of violence had existed before, Theodore Herzl is credited with putting forward Zionism as a cohesive ideology and political force. An Austrian journalist raised in a secular manner, Herzl hoped that Jews would be able to assimilate into European society. In 1897, he organized the First Zionist Congress in Basel, Switzerland, arguing that the Jewish people could only thrive in a territory of their own. In his words, the goal of Zionism was to “create for the Jewish people a home in Palestine secured by public law”. Inherent in this philosophy was the idea that Jews would have to be self-sufficient. A history of persecution in Europe had convinced Herzl that the Jewish people could not rely on any non-Jewish government for protection.

By 1914, at the end of the second *aliyah*, about 90,000 Jews were living in Palestine, spread across forty-three agricultural settlements. Whereas the first wave of immigrants had settled on *moshavot*, villages of independent farmers, the second wave from 1904 to 1914 organized themselves into *kibbutzim*, collective agricultural communities.¹¹ The *kibbutz* was a manifestation of Zionist ideology—a self-sufficient commune tied together by the dedication and hard work of its members.

If Theodor Herzl was the theorist of Zionism, the project needed an executor. David Ben-Gurion, who immigrated to Palestine from present-day Poland in 1906, would fit the bill. Ben-Gurion quickly became the leader of the *yishuv*, the Jewish population in Palestine prior to

¹⁰ Jewish Virtual Library. "Immigration to Israel." Jewish Virtual Library.
<https://www.jewishvirtuallibrary.org/the-first-aliyah-1882-1903>.

¹¹ Barnavi, Elie, and Miriam Eliav-Feldon. *A Historical Atlas of the Jewish People: From the Time of the Patriarchs to the Present*. New York: Schocken Books, 1999.

statehood. At the top of his mind was concern that claims of Jewish sovereignty over the territory could be disputed if areas were sparsely populated. Settlers needed to establish control of the land if they were to ever form their own national home. Moreover, population concentration could be a tactical weakness. If growing hostility from neighboring Arab governments heightened to military campaigns, it would be easy to wipe out Jewish ambitions completely if the population remained clustered. The key to survival seemed to be dispersion. But to convince people to move, they needed to know they would have access to basic infrastructure. With private enterprises unlikely to take on such a risky and uncertain project, the proto-government structures had to provide.¹²

Early governing organizations were dominated by the Labor movement, which itself was led by Ben-Gurion. Labor was influenced by the tenets of Zionism and organized accordingly. The *Histadrut*, Federation of Labor, was formed in 1920 as a centralized trade union but effectively controlled a large portion of the economy. It took on political and military roles as well, controlling land, labor, and capital in addition to providing housing and employment.¹³ By the 1930s, 75% of Jewish workers were members.¹⁴ The Jewish Agency, formed to cooperate with the British Mandatory Authority in the wake of the 1917 Balfour Declaration, took charge of funding. These institutions were guided by the World Zionist Organization, established in 1897 to organize the creation of a Jewish homeland.

¹² Senor, Dan, and Saul Singer. *Start-up Nation: The Story of Israel's Economic Miracle*. New York: Twelve, 2011.

¹³ Sorkin, David. "Israel." In *Jewish Emancipation: A History across Five Centuries*, 334-45. N.p.: Princeton University Press, 2019. <https://doi.org/10.2307/j.ctvdmx0kk.30>.

¹⁴ Koreh, Michal, and Daniel Béland. "The Fiscal Path to the State of Israel: Social Policy and State Building in the Yishuv during the Mandate." *Israel Studies* 22, no. 2 (2017): 145-68. <https://doi.org/10.2979/israelstudies.22.2.07>.

Formed in 1901, the Jewish National Fund was tasked with the most critical objective on the path to statehood: acquiring land. Throughout Ottoman and British rule, the JNF bought up land from absentee Arab landowners, at times buying at above the fair market value to prevent land from staying in Arab hands. In addition to the political practicality of land ownership under a centralized organization in the *yishuv*, public ownership had an idealistic allure. Public ownership echoed the collectivist vision of Zionism, particularly as it enabled the formation of *moshavot* and *kibbutzim*.¹⁵

As the JNF expanded, it implemented Herzl's insistence on self-sufficiency, not allowing Arab peasants to work on Jewish land. A like-minded Ben-Gurion is to have said "we will know we have become a normal country when Jewish thieves and Jewish prostitutes conduct their business in Hebrew". With this mentality, despite living under the same British mandatory law, the Jewish and Arab economies developed separately. Subsequent *aliyah* led to prolonged economic vitality, but due to the lack of integration, by 1947, the Jewish sector's national domestic product was 2.5 times larger than the Arab sector's.¹⁶

Immigration and centralization

The Zionist project needed people to populate the land in order to develop legitimacy. If Herzl's thesis was correct, Jews across Europe would need to immigrate to a Jewish homeland to escape anti-Semitism. Indeed, from 1948 to 1951, after statehood, immigrants doubled the

¹⁵ Leon, Dan. "The Jewish National Fund: How the Land Was 'Redeemed.'" *Palestine-Israel Journal of Politics, Economics & Culture* 12/13, no. 4/1 (2005): 115-23. Academic Search Complete (21401286).

¹⁶ Halevi, Nadav. "A Brief Economic History of Israel." <https://eh.net/encyclopedia/a-brief-economic-history-of-modern-israel/>.

Jewish population.¹⁷ With waves of mass migration, Israel would have to develop infrastructure to ease absorption. The collectivist Zionist vision, combined with the pressures of accommodating tens of thousands of people in short periods of time meant that the government took charge of infrastructure investment and planning, with little room for private sector actors.

Immigration is generally broken into distinct waves, or *aliyot*. Each wave brought new demographics to the *yishuv*, transforming the politics of the community. The first *aliyah*, from 1881 to 1882, included refugees of the Russian pogroms and numbered over 35,000. The second *aliyah* (1904-1914) brought around 40,000 Jews, largely the Zionists who would direct the early *yishuv*. The third *aliyah* (1919-1923) is often considered a continuation of the second. The fourth *aliyah* (1924-1929) was the result of anti-Jewish policies following an economic crash in Poland. Many of these immigrants were middle class small business owners, who established shops in the *yishuv* and spurred economic and industrial development. Already, problems with absorption were beginning to manifest: of the 82,000 who immigrated, 23,000 left. The fifth *aliyah* (1929-1939) followed from the rise of the Nazis in Germany. This influx consisted of many educated professionals. By the end of this wave, the *yishuv* numbered around 450,000.¹⁸

Of the *aliyot*, the immigration of Arab and Russian Jews were arguably the two most important waves in shifting Israeli identity away from its foundations in European Zionism. In 1950, two years after statehood, the Law of Return was passed, under Israel's first prime minister, David Ben-Gurion. The legislation codified the principle that every Jew has a right to immigrate to Israel. Arab Jews, in contrast to their European counterparts, felt no pressing need to leave their countries of origin. During the multiethnic Ottoman Empire, minority religions

¹⁷ Hacoen, Dvora. "Immigration Policy in Israel - the Reality behind the Myth." *Israel Studies Bulletin* 14, no. 1 (1998): 1-8. <http://www.jstor.org/stable/41805397>.

¹⁸ Jewish Virtual Library. "Immigration to Israel."

were tolerated and lived in relative peace with the Muslim majority. Under European colonizers, Jews often felt even more secure. The Jews who did migrate to the *yishuv* primarily did so for religious, rather than political, reasons. In the 1920s and 1930s, however, as Arab nationalism began to form in response to colonization, the status of Jews began to be threatened. By the 1940s, the situation had gotten progressively worse. Arab governments resented Israeli statehood, viewing it as a sort of vestigial colonialism. Anger and violence was directed at Arab Jews, often referred to as *mizrahim*, within these countries, leading to a wave of immigration to Israel. Around the same time, the Holocaust survivors were immigrating as well. The nascent state struggled with absorption, leading to a shortage of housing, high unemployment, and health problems. Many new immigrants, especially Arab Jews, lived in transitory areas, often at the periphery of cities.¹⁹ Decades later, Likud would tap into the resentment created by these inequities to transform the *mizrahi* population into a powerful voting bloc.

In the 1990s, the largest wave of immigration in Israel's history would shape the country's character in a different direction. World War II had liberated the concentration camps, but violent anti-Semitism still existed and sharpened under Joseph Stalin. Although physical violence at scale stopped after Stalin's death, campaigns that targeted Jews for "economic crimes" persisted.²⁰ When the Soviet Union finally lifted migration restrictions on Jews, hundreds of thousands immigrated, in all adding about one million to Israel's population of five million. These new immigrants were highly educated and tended to be secular. When settled, they experienced more upward mobility than the rest of the population.²¹

¹⁹ Hacohen, Dvora. "Immigration Policy in Israel - the Reality behind the Myth."

²⁰ Barnavi, Elie, and Miriam Eliav-Feldon. *A Historical Atlas of the Jewish People*.

²¹ Tslil, Aloni, and Zeev Krill. "Intergenerational Mobility of Earnings in Israel." Last modified July 15, 2017. https://issuu.com/dleventer/docs/tzlil_aloni_comment_on_intergenerat.

Culturally and politically, absorbing and assimilating massive waves of migrants was incredibly difficult for the state. However, in addition to tipping the scales in the demographic balance between Arabs and Jews on the contested land, immigration brought economic growth. The table below illustrates the impacts of integrated *olim* (immigrants who made *aliyah*) through distinct time periods.²²

Exhibit 1.

Aliyah and Growth, 1922, 2015 (annual percentage growth rates)

Period	<i>Olim</i> as a percentage of Established Population	Population Growth Rate	Capital stock Growth Rate (excluding housing)	Housing Stock Growth Rate	Per capita Output Growth Rate (not cyclically adjusted)
1922-1931	9.5	8.0	—	—	7.8
1932-1946	15.6	8.4	—	—	3.0
1947-1949	37.7	21.9	—	—	—
1950-1951	26.1	20.0	—	—	10.0
1952-1963	19.4	4.0	12.8	11.6	4.9
1964-1971	8.3	3.0	8.7	7.7	5.5
1972-1982	7.6	2.1	6.1	7.7	0.8
1983-1989	2.7	1.8	3.1	4.0	3.1
1990-2001	16.5	3.0	7.0	4.7	2.5
2002-2007	1.9	1.8	2.4	2.5	1.9
2008-2015	1.8	2.0	3.4	3.2	1.3

Source: Razin, 2017. Original data from Ben Porath (1985) for the years 1922-82. Central Bureau of Statistics (2016) and Bank of Israel (2016).

²² Razin, Assaf. "Israel's Immigration Story: Globalization Lessons." *NBER Working Paper Series*, 2017. <https://doi.org/10.3386/w23210>.

In writing the Law of Return, the state had committed itself to developing the country for whichever Jews wanted to come. As a result, Israel saw massive capital investments, which spurred economic growth and set a precedent of government economic involvement.

Military mobilization

From the time of the *yishuv*, the Jewish population in Palestine operated in a state of perpetual national insecurity. The wars of the Arab-Israeli conflict shaped the region culturally and politically. Domestically, the need to wage what were essentially wars for survival lead the government to intervene heavily economically, perpetuating the system of a large public sector for decades.

With the British mandate effectively ending on May 15th, 1948, it was inevitable that the State of Israel's declaration of independence, issued on midnight May 14th, 1948, would escalate Arab hostility to war. In Israel, the 1948 Arab-Israeli War that would follow was a war for the existential fate of the Jewish community. For this fledgling country to fight against an Arab coalition of Lebanon, Syria, Iraq, and Egypt, the entire country would have to be mobilized.

Militarily, the extent of mobilization was enormous: by November 1948, the census put the Jewish population at 713,000. The IDF estimated its forces to be 94,000. On the other hand, all the Arab armies together sent 68,000 men. Coinciding immigration waves helped the effort, and by the end of the war, recent immigrants constituted 20% of the Israel Defense Force's personnel. But the economy could not sustain a prolonged war. The new government quickly felt the strain of fighting a war of such scale, with the cost of local defense needs growing to be

33% of gross national product.²³ The severity of the war led the government to step in, directing the economy to meet the needs of the fight. As Mordechai Settner, chairperson of Economic Department of the National Committee, put it:

“The Yishuv is entering a struggle of its existence and future. This is a clear, as well as cruel reality for the present. In this struggle there is an important economic front, and only to the extent that we shall be successful in holding the line [economically], will we be able to hold firm in the overall struggle.”

Prime Minister David Ben-Gurion and Minister of Finance Eliezer Kaplan internalized the need for economic centralization, declaring the Defense Regime on October 2nd, 1947. The subsequent wartime economy was characterized by full employment, limited imports, rising cost of living, and heavy government intervention. For instance, in November 1948 the Center for Economic Coordination was established, responsible for creating and administering a food rationing program.

Israeli mobilization was ultimately effective, giving the new nation an upper hand in the conflict. In February 1949, armistice agreements were signed, delineating the borders that would exist until war broke out again in 1967. Recovering from the cost of the war, the state passed a new economic policy in 1952, devaluing the Israeli pound from an exchange rate of 2.80 USD/£ to 1.40 USD/ £.²⁴ The plan also began to relax

²³ Naor, Moshe. "Israel's 1948 War of Independence as a Total War." *Journal of Contemporary History* 43, no. 2 (2008): 241-57. <http://www.jstor.org/stable/30036505>.

²⁴ Jewish Telegraphic Agency. "Israel's New Economic Policy Clarified by Finance Minister." *JTA Daily News Bulletin*, February 15, 1952, 1-2. <https://www.jta.org/1952/02/15/archive/israels-new-economic-policy-clarified-by-finance-minister>.

price controls and eased active encouragement of new immigration to reduce the strain of absorption. From 1950 to 1965, real gross national product grew at an average annual rate of over 11%. This growth was fueled by a huge government investment program, made possible by United States aid, German reparations to individuals, the sale of Israeli government bonds abroad, and donations to the Jewish Agency (in charge of immigration absorption and agricultural settlement).²⁵ Nevertheless, the legacy of government intervention, entrenched by the war, continued. Protectionist measures were enacted with the intention of accelerating import substitution industrialization (ISI), a policy to replace foreign imports with native industry.

From 1946 to 1966, the government had completed most of the large-scale infrastructure projects, creating an opening to decrease government intervention and allow for private enterprise.²⁶ However, economic reforms were quickly sidelined with the outbreak of the Six Day War. Egyptian president Gamal Abdel Nasser called for the removal of the United Nations Emergency Force stationed between the Egyptian and Israeli borders. As Egypt mobilized with Syria, Jordan, and Iraq, an attack appeared to be imminent. In the Israel, mass graves were dug to prepare for the fatalities; in the national imagination, war would be akin to a second Holocaust. Acting on intelligence from the CIA, the Israelis struck first on June 5th, effectively wiping out the Egyptian and Syrian air forces. This early strike was debilitating to the Arab armies, and by June 10th, Syria, the last holdout, had accepted the cease-fire.

²⁵ Halevi, Nadav. "A Brief Economic History of Israel."

²⁶ Senor, Dan, and Saul Singer. *Start-up Nation*.

Israel had done more than survive; it had captured the Sinai Peninsula, Gaza Strip, West Bank, and the Golan Heights. Now, to consolidate its territorial gains, the government once again set out to centrally develop infrastructure to link the new areas to the rest of Israel. This flood of investment stimulated the economy, with investments in construction equipment alone rising 725% from 1967 to 1968.²⁷

Israeli settlers rushed to build houses in the West Bank and Gaza, territory that was technically occupied, but not part of Israel. The government built infrastructure to support these movements, and by 1973 there were seventeen settlements in the West Bank and seven in the Gaza Strip.²⁸ Transportation networks, in particular, were reconfigured to integrate the new territories into Israel, with the state building new roads and highways to connect settlements in the occupied territories.²⁹ Today, settlements, along with the roads and other infrastructure built for their communities control up to 40% of the West Bank's surface area.³⁰

The road to neoliberalism

The euphoria that followed 1967 came to a crushing end when war between Israel and its Arab neighbors broke out again in 1973. The period from 1967 to 1970, referred to as the “war of attrition” had seen sporadic fighting between Israeli and Arab forces, but came to an end when

²⁷ Ibid.

²⁸ Tahhan, Zena. "The Naksa: How Israel Occupied the Whole of Palestine in 1967." *Al Jazeera*, June 4, 2018. <https://www.aljazeera.com/indepth/features/2017/06/50-years-israeli-occupation-longest-modern-history-170604111317533.html>.

²⁹ Abu-Ayyash, Abdul-Ilah. "Israeli Regional Planning Policy in the Occupied Territories." *Journal of Palestine Studies* 5, no. 3/4 (1976): 83-108. <https://doi.org/10.2307/2536017>.

³⁰ Tahhan, Zena. "The Naksa: How Israel Occupied the Whole of Palestine in 1967."

Anwar Sadat became president, following Nasser's death. In contrast to Nasser, who had championed a bold, aggressive ideology of pan-Arabism that abhorred Israel, Sadat outlined more modest, pragmatic goals. After months of careful military planning, Egypt and Syria attacked Israel from two fronts on October 6th, on the holy day of Yom Kippur. Caught by surprise, Israel turned to the United States for help. The first country to extend *de facto* recognition of Israeli independence in 1945, the United States was initially hesitant to extend aid but quickly supplied arms through airlifts following news that the Soviet Union was resupplying Egypt and Syria. By the end of October, the United Nations adopted a resolution calling for the end of fighting, leading to a ceasefire on October 25th. Militarily, Israel had won the war. But psychologically, the nation felt far from victorious. Israelis suffered three thousand fatalities and had lost swathes of the Sinai. In response to criticisms of under-preparation, Labor party prime minister Golda Meir resigned in April of 1974.

Economically, the disaster was just beginning. The government's struggle to fund the war and maintain wages in its wake contributed to hyperinflation and a period of economic uncertainty termed the "lost decade". Inflation rose from 2% in 1967 to 500% in 1984, straining the government and compromising quality of life.³¹ It would not be until 1985 that stabilization efforts transformed the country's economic mindset and paved the way for the privatization of infrastructure.

The Yom Kippur War had seen the first powerful use of the Organization of Petroleum Exporting Countries (OPEC)'s economic weapon: the oil embargo. Imposed in retaliation for the United States' decision to resupply the Israeli military, the oil embargo banned petroleum

³¹ Fischer, Stanley. "The Israeli Stabilization Program, 1985-86." *The American Economic Review* 77, no. 2 (1987): 275-78. <http://www.jstor.org/stable/1805463>.

exports to countries that supported Israel in the war while simultaneously cutting production levels. The acute impact of the embargo in the United States was immortalized in iconic images of lines of cars at gas stations while the owners put up “Sorry NO Gas” signs. Inflation spiked globally, but in the coming years, Israel would experience hyperinflation that could not solely be explained by the effect of the embargo.

As with previous wars, 1973 had required mass mobilization of the population. Most of the labor force was pulled into the IDF for up to six months, stalling economic activity and dampening the country’s growth. Despite economic activity grinding to a halt, wages did not go down.³² Since the 1940s, largely due to the enormous influence of the *Histadrut*, wages had been tied to inflation, measured by the Consumer Price Index (CPI). In the midst of the Yom Kippur War, the government kept up with this social contract, inflating wages and consequently driving up the national debt. Concurrently, defense expenditures climbed with the escalating war.

Despite the end of the war, economic malaise would continue. Government intervention had the result of choking the country’s capital markets. In an effort to control capital, the state had taken charge of setting terms and interest rates for consumer and business credit. Pension funds and commercial banks were made to use their deposits to finance projects selected by the government. Due to both the fear of currency depreciation and the pride of maintaining a national currency, the foreign exchange market was tightly controlled. Holding an overseas bank account was illegal and currency could only be changed at banks, at a government-set exchange rate.³³ Concurrently, indexation, which had historically been a boon to Israeli labor, increasingly contributed to an inflationary spiral. As CPI rose, the *Histadrut* used its political weight to argue

³² Senor, Dan, and Saul Singer. *Start-up Nation*.

³³ *Ibid*.

for higher wages. Anticipating that inflation would be even higher next month, labor argued for higher wages in the present, creating a loop of inflationary pressure exacerbated by expectations.

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The situation grew increasingly untenable and reached a head in the 1977 elections. For the first time since 1968, the Israeli Labor Party would lose its position as the dominant party. The election was as much a vote against Labor as it was one for Likud. A survey from the period indicated that 81% of Israelis were dissatisfied with the management of the economy, a testament to the impact of hyperinflation on quality of life. In that context of economic struggle, a series of scandals, including misappropriation of public funds in 1976 and the discovery of Prime Minister Yitzhak Rabin's wife holding currency in a foreign bank account appeared particularly distasteful.³⁵

To its credit, Likud had seized upon a clever strategy of appealing to those who did not feel represented by Labor. By this time, *mizrahi* Jews constituted about half of the Jewish population, and over two-thirds of them voted for Likud, forming an important base for the party. Demographically, *mizrahim* were less affluent and more religiously devout. They resonated with the populist messages of the Likud campaign, which made promises to extend additional government support and services to their communities. Likud found another source of support in younger Israelis, who had likely developed political consciousness around the Yom Kippur War and associated Labor with the bitter defeat.³⁶

³⁴ Reuveny, Rafael. "Democracy, Credibility, and Sound Economics: The Israeli Hyperinflation." *Policy Sciences* 30, no. 2 (1997): 91-111. Accessed January 14, 2020. www.jstor.org/stable/4532401.

³⁵ Tessler, Mark. "The Political Right in Israel: Its Origins, Growth, and Prospects." *Journal of Palestine Studies* 15, no. 2 (1986): 12-55. <https://doi.org/10.2307/2536826>.

³⁶ Ibid.

Despite the historic political shift, economic fortunes did not turn brighter immediately. In the two governments that presided from 1977 to 1984, Likud held small majorities and relied on tenuous coalitions formed with other parties to consolidate power. Exacerbated by the political environment, inflation accelerated further, going from 31% in 1976 to 375% in 1984.³⁷ While Likud focused on expanding settlements in the West Bank and Golan Heights, other parties that made up their coalition had different primary goals. National religious parties wanted stronger claims for biblical territories, ultra-orthodox parties pushed for financial support for religious education, and centrists advocated for investing within Israel's 1967 borders. Various ministries pressured the Ministry of Finance to increase their budget allocations so that they could pursue these varied goals. They argued, much as *Histadrut* did, that the real value of their budgets lagged behind changes in CPI, again feeding into inflationary pressures. In addition to pacifying minority parties, Likud had its own promises to *mizrahim* to fulfill. In all, the political pressure to keep the coalition together necessitated greater spending, strongly disincentivizing bold action to address hyperinflation.³⁸

Hyperinflation was not the only issue coloring Israeli politics. Since the Camp David Accords in 1979, peace with Egypt had held and tensions with Syria and Jordan appeared to be cooling. In the summer of 1982, Likud Prime Minister Menachem Begin had launched "Operation Peace for Galilee", a strike intended to root out Yasser Arafat and the Palestine Liberation Organisation, which was operating from Lebanon. While the IDF succeeded in forcing Arafat to flee to Tunisia, Israel drew international—and some domestic—criticism for the resulting loss of Palestinian life. Exhausted with the war, Begin abruptly resigned in the middle

³⁷ Reuveny, Rafael. "Democracy, Credibility, and Sound Economics: The Israeli Hyperinflation."

³⁸ Ibid.

of the 10th Knesset's term. In the early elections that followed, war in Lebanon and hyperinflation dominated the talking points. Without a clear winner in the July elections, it took until September for the new 'national unity' government to be formed. Compromising between Labor and Likud, which had won 44 and 41 seats, respectively, the new government appointed Labor's Shimon Peres as Prime Minister and Likud's Yitzhak Shamir as Foreign Minister. After two years, they would switch roles³⁹.

With a broad coalition less tied to political winds than a one-party majority Knesset would have been, Israel was finally in a position to help itself. And given the increasingly delicate economic situation, reform would have to come quickly. Spending had driven up the deficit and grown the national debt so much so that the government had come to make up 76% of GDP.⁴⁰ External debt had risen from 59% of GDP in 1977 to 75% in 1984.⁴¹ As Peres took office, American president Ronald Reagan offered a \$1.5 billion grant to help Israel dig itself out of its financial hole. The US-Israeli relationship had grown progressively stronger over time, with the superpower using aid to Israel as a way to support its interests in the region. Against the backdrop of the Cold War, Israel was a useful counterbalance to Soviet allies including Egypt, Syria, Iraq, and Algeria.⁴² Every time Israel proved its military strength, it was rewarded. Aid increased 450% after 1967, another 800% after 1973, and another 400% in 1979, after the United States simultaneously lost an ally in Shah Reza Pahlavi to the Iranian Revolution and saw the

³⁹ "About the 1984 Elections." The Israel Democracy Institute.
<https://en.idi.org.il/israeli-elections-and-parties/elections/1984/>.

⁴⁰ Arlosoroff, Meirav. "July 1, 1985: The Day Israeli Capitalism Was Born." *Haaretz* (Israel), July 3, 2015.
<https://www.haaretz.com/israel-news/business/.premium-july-1-1985-the-day-israeli-capitalism-was-born-1.5375114>.

⁴¹ Krampf, Arie. *The Israeli Path to Neoliberalism*. Routledge, 2018. Digital file.

⁴² Central Intelligence Agency. *Soviet Policy Toward the Middle East*. 1986.
<https://www.cia.gov/library/readingroom/docs/CIA-RDP87T00787R000400440001-4.pdf>.

victory of the right-wing, free-market-friendly Likud party in Israel.⁴³ Reading this historical pattern, it was hardly a surprise that the United States would come to Israel's aid when the country found itself in economic distress. But again, the United States would use this opportunity to continue to cultivate the Israel best aligned with American interests. As Secretary of State George Schultz made clear, aid was contingent on Israel making serious and dramatic changes to its financial operations.

The first few efforts at addressing the issue resulted in 'package deals' between the government and *Histadrut*. In November of 1984, a deal was reached in which *Histadrut* agreed to wage freezes. While inflation dropped to 4.5% per month over the next two months, the budget deficit had not seriously been addressed and inflation picked back up again, at a rate averaging 350% for the first half of 1985.⁴⁴ It became clear that achieving a sustainable level of economic normalcy would require decisive—and likely painful—policy. As the head of the State Revenues Division, Yoram Gabay explained:

“The package deals tried to work through psychology and influence expectations.

That's bluffing. Psychology doesn't work in economics, only real actions.”⁴⁵

Despite the irony of such a quote coming from the nation that would produce the most notable behavioral economists decades later, Gabay was correct in his assessment that the situation

⁴³ Zunes, Stephen. "Why the US Supports Israel." Institute for Policy Studies. Last modified May 1, 2002. https://ips-dc.org/why_the_us_supports_israel/.

⁴⁴ Fischer, Stanley. "The Israeli Stabilization Program, 1985-86."

⁴⁵ Arlosoroff, Meirav. "July 1, 1985: The Day Israeli Capitalism Was Born." *Haaretz* (Israel), July 3, 2015. <https://www.haaretz.com/israel-news/business/.premium-july-1-1985-the-day-israeli-capitalism-was-born-1.5375114>.

would not improve without breaking the bargaining power of *Histadrut*, which an article from the time described as the “single most powerful economy entity in the country”.⁴⁶ Rafael Reuveny writes that three political factors had a role finally bringing about stabilization: (1) politicians formed a broad coalition that allowed them to act with the country’s long-term economic interests in mind, rather than their own political careers, (2) *Histadrut* and the business community came around to supporting major reform when the public no longer participated in demonstrations against budgetary cuts, and (3) the public believed the government’s efforts were credible and stopped anticipating increasingly higher inflation.⁴⁷

On July 1st, 1985, the government released the stabilization program. Among its major points, the plan included a \$462 million budget cut, of which 40% had been allocated to subsidies, a 20% devaluation of the Israeli shekel, higher reserve ratios, and a prohibition of dollar-denominated savings accounts.⁴⁸ Monthly inflation rates fell, dropping to 11% in the third quarter of 1985 and as low as 1% a year after.⁴⁹ The decisive and sharp action plan had worked—Israel was pulled out of its economic slump. Moreover, the stabilization program had consequences for how the state would operate going forward. Crafted by Michael Bruno and Eitan Berglas, with help from neoliberal American advisors George Schultz, Herbert Stein, and Stanley Fischer, it marked a transformation in Israel’s attitude towards government intervention in the economy. The lesson of hyperinflation had been that the state was overgrown—in an effort to provide for the public, the government had extended itself too far. In addressing this

⁴⁶ Farrell, William. "Israel Turns to Milton Friedman." *The New York Times*, June 26, 1977. <https://www.nytimes.com/1977/06/26/archives/israel-turns-to-milton-friedman.html>.

⁴⁷ Reuveny, Rafael. "Democracy, Credibility, and Sound Economics: The Israeli Hyperinflation."

⁴⁸ Krampf, Arie. *The Israeli Path to Neoliberalism*. Routledge, 2018. Digital file.

⁴⁹ Bahar, Dany. "How Shimon Peres saved the Israeli economy." The Brookings Institution. Last modified September 30, 2016. <https://www.brookings.edu/blog/markaz/2016/09/30/how-shimon-peres-saved-the-israeli-economy/>.

overextension, the authors of the program instituted a new, distinctly neoliberal mindset to Israeli economic policy.

In the capital market, the state relinquished its role in regulating credit availability by reducing the minimum required investment in government-approved long-term savings programs and government bonds. In financial markets, restrictions on international financial trade were lifted. Even *Histadrut*, which had been an enormous force in Israeli political and economic activity transitioned away from its involvement in welfare programs and began operating as a traditional workers' union. Unionization overall dropped, going from 80-90% in the early 1980s to 30-40% in the 2010s.⁵⁰ Across the economy, markets were opening up.

As the state pared back its responsibilities, it embarked on a privatization plan that would continue into the following decades. Of the thirteen largest government companies, which made up 96% of total government company income and 97% of government company assets, ten were in the infrastructure sector.⁵¹ Throughout its political history, infrastructure had been an integral part of consolidating Israeli territorial claims. As the Arab-Israeli conflict cooled, infrastructure continued to be a state priority for maintaining quality of life. Navigating the process of privatization would require balancing the public's need for reliable access to services and the state's need to divest from the capital intensity and risk of operating such businesses.

The following case studies consider three forms of privatization: (1) the full privatization of a government monopoly in the case of Bezeq, the telecommunications company, (2) the proposed minority stake sale of a government company, Mekorot, the national water authority, and (3) the application of public-private-partnerships to develop desalination plants.

⁵⁰ Paz-Fuchs, Amir, Ronen Mandelkern, and Itzhak Galnoor, eds. *The Privatization of Israel: The Withdrawal of State Responsibility*. N.p., 2018. <https://doi.org/10.1057/978-1-137-58261-4>.

⁵¹ Ibid.

Bezeq – Fully privatizing a monopoly

“Israel has enacted a series of economic reforms over the last twenty years that have fundamentally transformed our economy... All of these reforms will and are directed to one goal - to make Israel's economy freer, more competitive so that we can unleash the enormous potential that is in our people.”

Benjamin Netanyahu, Prime Minister

The deregulation and privatization of Bezeq were both undertaken haltingly, leading to mismatches between the company's regulatory marketplace protections and its private ownership. The longer privatization took, the longer Bezeq retained its power, making it increasingly difficult to break its monopolies, particularly its most lucrative monopoly in domestic telecommunications. Today, Bezeq is a target of frustrations about economic concentration, a problem present throughout the larger Israeli economy.

Establishing a conglomerate

Founded in 1984 as a government company, Bezeq is Israel's largest telecommunications company. Initially created to improve upon the inefficiency of the Ministry of Communications, which was previously responsible for installing and servicing phone lines, Bezeq expanded into other telecommunications subsegments over time. Today, the company's activities can be broken into four segments:

1. Domestic Communications

Domestic communications infrastructure continues to be Bezeq's largest segment, making up 41% of revenue in FY 2018.⁵² Today, the business provides internet infrastructure services, basic telephony, and transmission and data communications. As of 2017, the company reported 1.9 million access lines across Israel, with a market share of 53% of the private telephony sector, and 72% of the business sector. Additionally, the company has installed over 1.6 million high-speed retail and wholesale broadband lines, encompassing 70% of the market.⁵³

2. Cellular Communications

Operated under subsidiary Pelephone Communications Ltd., cellular communications infrastructure offers package services that include basic cellular services, browsing and data communications services, and messaging. Furthermore, Pelephone offers content services such as anti-virus, cyber security, and a music library, IOT services for smart buildings, and roaming services for international travel. Complementing these services, the company also sells terminal equipment such as mobile phones, tablets, laptops, and more. Today, Pelephone services approximately 1.9 million subscribers, about 21.9% of the Israeli population.^{54,55}

In 1986, Israel awarded the first mobile phone network contract to Motorola Corporation, which, together with Bezeq, established Pelephone. The company lost its monopoly in 1994 when the government granted a license to Cellcom in order to create a competitive market.

⁵² "Bezeq Financial Statements." Table. FactSet. <https://www.factset.com/>.

⁵³ *Bezeq 2017 Q2 Investor Presentation*. 2017.
<https://ir.bezeq.co.il/static-files/7e110436-83c4-4ca5-becb-ce961b12fd45>.

⁵⁴ *Bezeq 2019 Q3 Investor Presentation*. 2019.
<https://ir.bezeq.co.il/static-files/2fc34f09-fe8f-4ea3-a4a4-8a8acfa41305>.

⁵⁵ "Middle East: Israel." In *The World FactBook*.
<https://www.cia.gov/library/publications/the-world-factbook/geos/is.html>.

Cellcom won the license by promising prices that were 6.5% of what Pelephone was charging. Forced to adapt, Pelephone cut prices as well, although they remained above Cellcom's. The following years saw additional operators enter the market, with licenses issued to Partner Communications in 1997 and MIRS Corporation in 2001.⁵⁶ In 2004, Bezeq acquired all of Pelephone, following a change in regulations that had previously prevented Bezeq from becoming the sole owner. In a statement, Chairwoman Miki Mazar described the purchase as critical to turning Bezeq into "a communications group with the ability to provide all of the modern communications products".⁵⁷

3. Multi-channel Television

DBS Satellite Services, known commercially as "yes", is a wholly-owned subsidiary of Bezeq that offers multi-channel satellite and online television transmissions (OTT). DBS' OTT offering, called 'STINGTV', offers both video-on-demand (VOD) and digital terrestrial television content.^{58,59}

Funded by the Rothschild Foundation, television first came to Israel in an educational capacity in 1968. This relatively late introduction was the result of two factors related to early leaders' concerns about protecting the culture of the new state. Early statesmen were concerned that exposure to Western lifestyles through television would create the desire for an unattainable

⁵⁶ Schejter, Amit M. "Israeli cellular telecommunications policy." *Telecommunications Policy* 30 (2006). <https://doi.org/10.1016>.

⁵⁷ "Bezeq becomes 100% Owner of Pelephone." Bezeq Investor Relations. Last modified August 29, 2004. <https://ir.bezeq.co.il/news-releases/news-release-details/bezeq-becomes-100-owner-pelephone>.

⁵⁸ VOD refers to media distribution through which viewers can choose which programs they would like to view at any time. VOD can also be accessed without a traditional satellite television. Examples familiar to American readers include Netflix and entertainment systems on airplanes.

⁵⁹ DTT refers to a technology by which digital signals are broadcast from land-based (rather than satellite) television stations by radio waves.

standard of living. Additionally, the deluge of foreign language programming threatened to undermine the project of establishing modern Hebrew as the common language of a multiethnic population. Eventually, the state-run Israeli Broadcast Authority (IBA) began sharing a channel with the educational television (IETV). Even as the world moved to color television, the IBA removed color from its broadcasts. Again, the government's logic was that color TV would be unfairly aspirational for the populace. Although the Supreme Court ruled in 1978 that the practice violated rights, the episode was a striking example of both the government's paternal ethos and its ability to impose its will. Multichannel television picked up in the mid-1990s, with the new channels attracting viewership from minority communities who the secular, Ashkenazi government operators had not catered to.⁶⁰

DBS Satellite was founded in 2000 and serviced customers through the AMOS-2 and AMOS-3 satellites. Today, the Israeli market is dominated by yes, a satellite provider, and HOT, a cable provider that entered the market in 2003. Bezeq built its stake in DBS gradually, eventually exercising warrants in 2004 to become the company's largest shareholder.⁶¹ In March 2015, Bezeq acquired the remaining stake in the company from Eurocom DBS, in what would later be revealed to be a spurious transaction.⁶²

⁶⁰ Weiss, Shayna. "Israeli Television." My Jewish Learning.
<https://www.myjewishlearning.com/article/israeli-television/>.

⁶¹ *Bezeq Annual Report for 2004*. 2005.
<https://ir.bezeq.co.il/static-files/b1297d1e-2c97-4370-88e4-f5fa35254ea1>.

⁶² Halbfinger, David M. "The Cases Against Netanyahu and a Decision to Indict." *The New York Times* (New York, NY), February 28, 2019.
<https://www.nytimes.com/2019/02/28/world/middleeast/benjamin-netanyahu-indictment.html>.

4. International Communications

Today Bezeq International's revenue primarily comes from business internet and telecommunications services outside of Israel. The subsidiary acts as an internet-service-provider (ISP), network-equipment-provider (NEP), and offers infrastructure and communication technology (ICT) solutions.^{63,64} The segment's remaining revenue comes from voice services, which enable international telecommunications.⁶⁵

Bezeq's international telephony monopoly was dismantled relatively quickly. In July 1997, the government allowed two new operators—Barak and Golden Line—to enter the market. Their services were priced significantly lower than Bezeq's, leading Bezeq International to cut its own fees by more than 50%. Within the first three months of competition, Bezeq International's share of the market fell from 100% to 60%.⁶⁶ The company began providing ISP services to private and business customers abroad in late 2011, when its 'Jonah' submarine cable between Israel and Italy began operations.⁶⁷

The process of privatization

As displayed in Exhibit 3, the process of privatization began in 1994, with the government listing 23% of the company on the Tel Aviv Stock Exchange.⁶⁸ In the same year, the

⁶³ An NEP builds and maintains mobile, internet, and enterprise networks.

⁶⁴ Examples of ICT solutions include web hosting, maintenance and support of networks, cloud computing, and security and risk management services.

⁶⁵ *Bezeq Periodic Report for 2018*. March 27, 2019.
<https://ir.bezeq.co.il/static-files/45d98515-d863-46b9-a2a2-521ad7ce2745>.

⁶⁶ Spiegel, Yossi. *Lecture 13: Deregulation and Reform in the Israeli Telecommunications Industry*.

⁶⁷ *Bezeq Financial Statements 1999*. December 31, 1999.
<https://ir.bezeq.co.il/static-files/92a3c135-ad88-4537-bff7-75cc027d75d8>.

⁶⁸ Stopp, Christine. "Israel: Still Reeling, or on the Rebound?" *International Herald Tribune*, August 13, 1994.
<https://www.nytimes.com/1994/08/13/your-money/IHT-israel-still-reeling-or-on-the-rebound.html?searchResultPosition=1>.

cellular monopoly was broken, as described above, with the Ministry of Communications granting Cellcom a license to operate. In 1997, the international monopoly was broken as well with the entrance of competitors Barak and Golden Line. However, it would take another four years to begin the process of deregulating the company's domestic monopoly. Even after regulation to do so was passed, Bezeq exhibited strong market dominance and engaged in anti-competitive practices.

Exhibit 3.

Date	Significant Ownership Change	Largest Shareholder	Transaction Implied Valuation (USD)
1994	Government lists 23% of stock on Tel Aviv Stock Exchange	Government	-
2-May-95	Cable and Wireless PLC of Britain purchases 7% stake for \$101.6mm	Government	1,451
15-Jul-97	Government sells Merrill Lynch 12.4% stake for \$250mm	Government	2,016
18-Jul-98	Merrill Lynch sells HSBC 4% stake for \$102.5mm	Government	2,563
25-Oct-99	Cable and Wireless PLC sells 12.75% stake to local investor for \$630mm	Government	4,941
Jan-01	Ze'evi Group owns 19.4%, government owns 54.6%	Government	-
10-May-05	Government sells 30.6% stake to Apax-Saban group for \$975mm	Apax-Saban	3,186
26-Oct-09	Apax-Saban group sells 30.6% stake to 012 Smile Communications (renamed B Communications) for \$1.8bn	B Communications	5,882
20-Feb-14	Government sells remaining 0.97% stake to unnamed buyer for \$43mm	B Communications	4,433
11-Nov-19	Government approves B Communications proposed sale of 26.34% stake to Searchlight Capital Partners for \$183mm	Searchlight Capital Partners	695

The Telecommunications Act of 1982 established Bezeq as a government-corporation, creating its monopoly. As prices began to climb without market-based competition to control them, the Knesset passed the Israel Restrictive Trade Practices Act of 1988, which would become the basis of the country's economic competition law. The policy introduced price caps, artificially reducing the cost of domestic phone service to consumers.⁶⁹

⁶⁹ Spiegel, Yossi. *Lecture 13: Deregulation and Reform in the Israeli Telecommunications Industry*. 2003. <https://www.tau.ac.il/~gandal/lecture13.pdf>.

Nevertheless, Bezeq continued operating as a monopoly in domestic phone service, a dynamic that would not begin to change until 2001. While the program of privatization had made sense in the ideological fervor of 1985, in practice it was proved to be more difficult. To disentangle Bezeq, Israel would have to overcome outcry from the Histadrut and variable political climates.

By 1997, fiscal pressure had reignited the need for privatization. Then-prime minister Benjamin Netanyahu had run on a campaign that touted the free-market, but now that GDP growth was smaller than expected, Netanyahu needed new ways to finance the growing deficit. The slowdown was largely attributed to a reduction in the influx of immigrants. The economic boost of massive migration from the USSR was fading, resulting in less than expected tax revenue and tourism. To bridge the gap, Netanyahu sold 12.4% of Bezeq to Merrill Lynch in July. In response, the Histadrut promptly organized strikes involving 60,000 workers at ten government companies, 6,000 of which worked at Bezeq. But for all of strength the imagery of a general strike conveyed, the Histadrut knew that privatization itself could not be blocked. A few days later, the union resumed negotiations with Netanyahu, pushing to secure the maximum benefits and severance possible for employees who would be terminated after privatization, rather than seeking to block further sales.⁷⁰

Even as governments changed, privatization continued to be a priority. After beating Netanyahu in the 1999 elections, Ehud Barak and his administration inherited a list of proposed privatizations. El Al, the national airline, was planned to be the next project, but opposition from

⁷⁰ Schememann, Serge. "In Fight over Privatization, Netanyahu Wins a Round." *The New York Times* (New York, NY), July 26, 1997, sec. 1, 3.
<https://www.nytimes.com/1997/07/26/world/in-fight-over-privatization-netanyahu-wins-a-round.html?searchResultPosition=120>.

Orthodox Jews, who feared a foreign or private-sector owner ignoring the ban on flying on the Shabbat, forced the plan to be abandoned. Next in line was Bezeq. By then, the telecom giant had come under criticism for being a costly and outdated monopoly—by 2000, both long-distance and cellular service had been opened to market forces; the general public could not understand why domestic service had not.⁷¹ Bezeq appeared to be struggling; new competition in international and cellular markets had forced the company to cut its workforce (and pay severance) for over two thousand workers, resulting in a net loss for the quarter. Even ignoring the one-time charges associated with the firings, a majority of profits came from domestic service, its last monopoly. To taxpayers, it appeared as though they were subsidizing a company that was only surviving by overcharging them.⁷²

As the state began to make progress in privatization, signs of economic concentration derailed the first significant attempt: an initial public offering. In early 2001, plans were made to list the government's controlling stake on the Tel Aviv Stock Exchange. However, the listing, which would have earned up to two billion for the Israeli treasury and boosted the overall market, was scrapped after police arrested Gad Ze'evi, the man behind the Ze'evi Group, and Bezeq's largest private shareholder. Soon intrigue around the arrest eclipsed the privatization plan. Security forces were concerned that Ze'evi had acted on behalf of an Uzbekistani immigrant with ties to the Russian mob. Concerns rose that the sale of one of Israel's largest companies to such an actor would have resulted in an increasingly large share of the economy in

⁷¹ Orme, William A., Jr. "Israel Loosens Telephone Monopoly's Grip." *The New York Times* (New York, NY), September 5, 2000, International Business, 4. Accessed February 15, 2020. <https://www.nytimes.com/2000/09/05/business/international-business-israel-loosens-telephone-monopoly-s-grip.html>.

⁷² *The New York Times* (New York, NY). "Bezeq Reports 3rd-Quarter Loss After Expenses for Cutting Jobs." November 27, 2000, sec. C, 10. <https://www.nytimes.com/2000/11/27/business/bezeq-reports-3rd-quarter-loss-after-expenses-for-cutting-jobs.html>.

a few, possibly foreign hands. Instead of the cash flow it had counted on, the government found itself facing a paper loss of \$400 million following the drop in market capitalization that resulted from the scandal.⁷³

That September, the Knesset voted to proceed with privatization, but it appeared that the market had soured.⁷⁴ It would take another four years to find a buyer. In May 2005, the government sold a 30.6% stake to the Apax-Saban-Arkin group, a syndicate made up of Apax Partners, the London-based private equity firm, Haim Saban, an Israeli media entrepreneur, and Mori Arkin, an Israeli pharmaceutical tycoon.⁷⁵

In theory, Bezeq was now a private actor in a competitive market. Indeed, the government had started to regulate away the company's domestic telephone monopoly in 2001. But despite these measures, Bezeq continued to display monopolistic tendencies. In July 2001, just months after the Ze'evi scandal, the Knesset passed the 2001 Telecommunications Law. The law cancelled the policies that had given Bezeq exclusivity in providing fixed-line domestic telecommunications services and gave the Ministry of Communications the ability to grant licenses to competitors hoping to provide the same service.⁷⁶ As the market opened up, Bezeq was determined to hold on to its share.

⁷³ Orme, William A., Jr. "Intrigue Derails a Public Offering; Israel Halts Sale of Phone Company." *The New York Times* (New York, NY), April 3, 2001, International Business, 1. Accessed February 15, 2020. <https://www.nytimes.com/2001/04/03/business/intrigue-derails-a-public-offering-israel-halts-sale-of-phone-company.html>.

⁷⁴ "Government votes to proceed with privatization of Bezeq." *The Street*. Last modified September 16, 2001. <https://www.thestreet.com/technology/government-votes-to-proceed-with-privatization-of-bezeq-10001109>.

⁷⁵ *The New York Times*. "World Business Briefing | Middle East: Israel: Telecom Bid Accepted." May 10, 2005. <https://www.nytimes.com/2005/05/10/business/world-business-briefing-middle-east-israel-telecom-bid-accepted.html?searchResultPosition=199>.

⁷⁶ *Directors' Report on the State of the Company's Affairs for the year ended December 31, 2002*. March 6, 2003. <https://ir.bezeq.co.il/static-files/459fce1a-0c52-4d32-9bc3-1e666e6bc471>.

Since 1988, the Israel Antitrust Authority had declared two instances of abuse of power. In 1997, after losing its cellular monopoly, the company had engaged in “price obfuscation”, deliberately creating misleading advertising that inaccurately compared Bezeq’s plans to those of new rivals. These messages, coming from what had been up to that point Israel’s only cellular provider, were found to be both significant and harmful to new entrants. Following the opening of the domestic market, the company fell back on similar tactics. In 2007, Bezeq was accused of purposefully failing to reconnect the interface between its own network and that of a competitor, HOT Telecommunication Systems. As a result, HOT’s network was impaired for thirty-four hours, undermining customers’ confidence and its market position.⁷⁷

The mismatch between privatization and deregulation may have harmed consumers and competitors, but for the Apax-Saban-Arkin group, Bezeq’s continued market dominance was enormously profitable. In addition to benefiting from the lingering monopoly, the group grew the internet and cellular businesses while trimming losses from satellite television.⁷⁸ Packaging Bezeq as the only telecommunications company capable of offering a “quadruple play” (cellular, domestic, internet, and satellite), the consortium advertised heavily throughout the country.⁷⁹ Over the 2005-2009 period, Bezeq saw a significant rise in annual revenue, even as domestic communications as a percent of sales plateaued (*Exhibit 4*). The Apax-Saban-Arkin group exited the investment in 2009 by selling its stake to 012 Smile Communications, later renamed B

⁷⁷ The Organisation for Economic Co-operation and Development. *Israel – Accession Report on Competition Law and Policy*. 2011. <https://www.oecd.org/competition/50104572.pdf>.

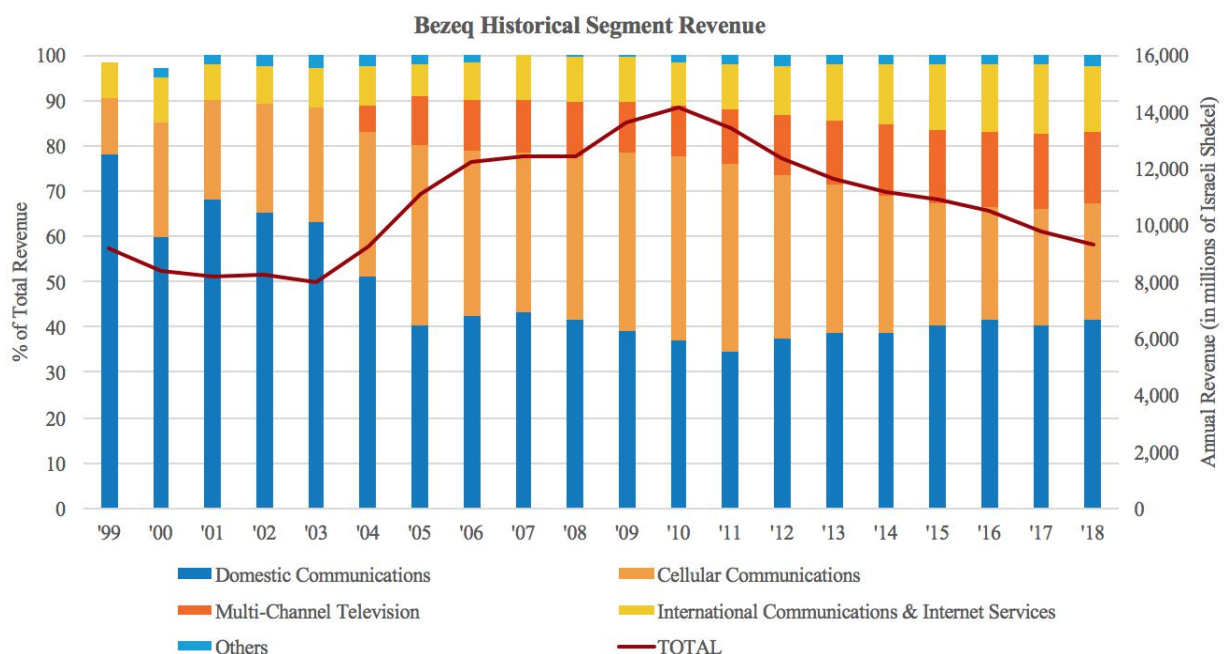
⁷⁸ The New York Times. "2 Mideast telecoms post profit rise - Technology - International Herald Tribune." August 15, 2006.

<https://www.nytimes.com/2006/08/15/technology/15iht-metech.2488860.html?searchResultPosition=214>.

⁷⁹ *Speaking the Right Language: Apax Partners Bezeq Case Study*. 2009. <https://www.apax.com/media/435879/Bezeq.pdf>.

Communications. The approximately \$1.8 billion transaction value translated to over 300% return for the consortium.⁸⁰

*Exhibit 4.*⁸¹



In some sense, the sale had shifted the former government monopoly from the hands of one group of tycoons to another. Through the purchase of a controlling stake in Bezeq, Shaul Elovitch, brought the company into the Eurocom Group, a holding company involved in the manufacturing of telephone and cellular equipment, office machinery, and telecommunications. Elovitch financed nearly 85% of the 6.5 billion shekel transaction with debt, a level of leverage that would prove unsustainable and ultimately disastrous.⁸²

⁸⁰ "Israel's 012 Smile to Buy Controlling Stake in Bezeq." *DealBook*, October 26, 2009. <https://dealbook.nytimes.com/2009/10/26/israels-012-smile-to-buy-controlling-stake-in-bezeq/?searchResultPosition=292>.

⁸¹ Financials prior to 1999 are not reported as the Israel Company Law requiring public companies to report financial statements was passed in 1999.

⁸² Rochvarger, Michael. "Rise and Fall of Telecom Tycoon at the Center of the Netanyahu Corruption Scandal." *Haaretz* (Tel Aviv, Israel), February 22, 2018.

Recent indictments against Elovitch reveal how the scale and connections of the one-time monopoly were abused for the sake of personal profiteering. In 2018, the Israel Securities Authority began investigating the sale of Yes to Bezeq. Authorities found that Elovitch, who owned stakes in both yes and Bezeq, sold yes to Bezeq at a transaction value several times more than what independent valuations placed the true value at, in the process enriching him personally with over \$32 million.⁸³ Over the course of his ownership, Elovitch directed approximately \$4 billion of Bezeq's dividends to cover debt payments for other companies within the Eurocom Group. Doing so shaved down shareholder equity to just 12.8% of what it had been prior to the takeover.⁸⁴

Benjamin Netanyahu, who served as Minister of Communications in addition to his role as Prime Minister from 2014 to 2017, had approved the yes-Bezeq deal and would later press Elovitch for favors in return. Case 4000, for which Netanyahu has been indicted and is awaiting trial at the time of this writing, charges the politician with asking Elovitch to demand favorable press coverage of Netanyahu and his wife from the online news publication, Walla, which is owned by Bezeq. According to prosecutors, these demands increased around the 2013 and 2015 elections.⁸⁵

If these charges touch a particular nerve with Israelis, it is because they support a larger narrative of rising economic concentration. The privatization of Bezeq, which resulted in one of the country's largest companies falling in the hands of one wealthy individual can be understood

<https://www.haaretz.com/israel-news/the-telecom-tycoon-at-the-heart-of-the-netanyahu-corruption-scandal-1.5844959>.

⁸³ Halbfinger, David M. "The Cases Against Netanyahu and a Decision to Indict."

⁸⁴ Rochvarger, Michael. "Bezeq's in a Free Fall, but Does Anyone Want to Buy It?" Haaretz (Tel Aviv, Israel), July 4, 2018.

<https://www.haaretz.com/israel-news/business/bezeq-s-in-a-free-fall-but-does-anyone-want-to-buy-it-1.6242431>.

⁸⁵ Halbfinger, David M. "The Cases Against Netanyahu and a Decision to Indict."

within this larger context. As of 2017, the ten largest business groups in the economy held nearly 30% of the total stock market value.⁸⁶ For the common citizen, this level of concentration results in higher prices and fewer choices. In 2011, protestors filled the streets of Tel Aviv, demanding more affordable housing (Israel has the eighth highest cost of living in the world) and cheaper essential goods under the overall cry to 'minimize social inequalities'.^{87,88} Netanyahu responded by establishing a 'concentration committee', but as the recent corruption cases against the prime minister himself indicate, there is still work left to be done.

Today, cries against economic concentration cite privatization as the root cause of the crisis. But as Gazit and Sauer suggest, economic concentration in Israel is not because of privatization, but rather, because of incomplete privatization.⁸⁹ The story of Bezeq illustrates as much. By waiting as long as 2001 to break the company's most lucrative monopoly, the state allowed its market power to grow, resulting in inflated prices for consumers. Furthermore, the mismatch in timing between privatization and regulation resulted in the still-dominant company falling into private hands, where its scale and reach were used for corrupt applications. In transferring the country's most important telecommunications asset from public to private hands, the state reduced its exposure to the company's risk without protecting customers from the repercussions.

⁸⁶Gershgoren, Gitit Gur, Liza Teper, Guy Sabbah, and Efraim Fortgang. *Developments in the Structure of Holdings in Israel's Capital Market 2010-2018*. July 2019. http://www.isa.gov.il/sites/ISAEng/Departments/Economic-research/Documents/Developments_in_the_Structure_of_Holdings_in_Israel.pdf.

⁸⁷ Surkes, Sue. "Monopoly nation: How a handful of firms control prices, hold Israelis ransom." *The Times of Israel* (Jerusalem), February 26, 2020. <https://www.timesofisrael.com/monopoly-nation-how-a-handful-of-firms-control-prices-hold-israelis-to-ransom/>.

⁸⁸Bronner, Ethan. "Protests Force Israel to Confront Wealth Gap." *The New York Times* (Tel Aviv, Israel), August 11, 2011. <https://www.nytimes.com/2011/08/12/world/middleeast/12israel.html>.

⁸⁹ Gazit, Yarden, and Robert M. Sauer. "Economic Concentration in the Start-up Nation: Is Privatisation to Blame?" *Economic Affairs* 34, no. 2 (2014): 213-22. <https://doi.org/10.1111/ecaf.12070>.

Mekorot – Minority sale of a government company

"The history of Jewish settlement in the country is, first and foremost, the story of the search, discovery and exploitation of new water sources".

– Moshe Sharet, Former Israeli Prime Minister and Foreign Minister

The politics of water

Water in Israel has historically held a great deal of political significance, making the water infrastructure that serves the country particularly important as a source of national pride and security. As the first Jewish settlers came to mandatory Palestine, claiming territory was the most important objective. As previously mentioned, population dispersion was critical both for laying claim to the land and for national security; a concentrated population was more vulnerable to attacks.

The geography of mandatory Palestine would complicate this task. The area of land that makes up contemporary Israel and the occupied territories extends from the fertile north, which contains water sources, to the arid Negev Desert in the south.⁹⁰ In mandatory Palestine, as throughout the rest of the Middle East, water scarcity was a fact of life. Nearly 60% of contemporary Israel's territory is considered arid or semi-arid.⁹¹ Moreover, early settlers formed *kibbutzim* and *moshavot*, primarily agricultural communities that required irrigation to cultivate

⁹⁰ Alatout, Samer. "Locating the Fragments of the State and Their Limits: Water Policymaking in Israel during the 1950s." *Israel Studies Forum* 23, no. 1 (2008): 40-65. <http://www.jstor.org/stable/41805208>.

⁹¹ Sitton, Dov, Dr. "FOCUS on Israel: Development of Limited Water Resources-Historical and Technological Aspects." Israel Ministry of Foreign Affairs. Last modified September 20, 2003. <https://mfa.gov.il/mfa/aboutisrael/land/pages/focus%20on%20israel-%20development%20of%20limited%20water%20reso.aspx>.

crops. Providing water for these settlers throughout the *yishuv* would require reliable infrastructure.

Securing a national water source

The project of water infrastructure was particularly urgent given that the early Zionist project could not rely on its neighbors for assistance. This emphasis on self-sufficiency was inculcated by Zionist ideology and later reinforced by hostility from Arab states. Consequently, centralized water infrastructure preceded Israeli statehood. Mekorot (“sources” in Hebrew) was formed in 1937 and owned collectively by three Zionist institutions, the Jewish National Fund, the Palestine Land Development Corporation, and the Nir Corporation.⁹² The company drew water from three wells in the valley of Jezreel, and through a system of metal pipes kept under pressure, two concrete tanks, and two open reservoirs, was able to provide reliable water.⁹³

As early as the Arab-Israeli War of 1948, water infrastructure proved to be a security concern. Early into the conflict, Jerusalem was besieged, cutting off Jewish inhabitants of the city from the rest of the newly-recognized nation. Anticipating the situation, Mekorot conducted “Operation Delivery”, using a twenty-kilometer-long pipe to divert water from the Jordan River into the city.⁹⁴

In 1949, following the close of the 1948 war, the state purchased shares of Mekorot previously owned by the Zionist organizations, turning the organization into a government

⁹² Paz-Fuchs, Amir, Ronen Mandelkern, and Itzhak Galnoor, eds. *The Privatization of Israel*.

⁹³ Sitton, Dov, Dr. "FOCUS on Israel: Development of Limited Water Resources-Historical and Technological Aspects."

⁹⁴ "80 Years of Mekorot: From Fantasy to Reality." Mekorot: Israel National Water Co. <http://www.mekorot.co.il/Eng/newsite/InformationCenter/Milestones/Pages/80Years.aspx>.

company. Ten years later, the 1959 Water Law would codify water as a public good and task Mekorot with pumping, transporting, and distributing the resource.⁹⁵

Mekorot's primary project was developing the National Water Carrier, completed in 1964. Beginning in the mid 1940s, American scientists began publishing work about possible water infrastructure in the region. Work by W.K Lowdermilk, J.B. Hays, and J.S. Cotton all contributed to the first blueprints for the National Water Carrier.⁹⁶ The original plan was to convey water from the Jordan River to the Negev Desert. Construction began in 1953, but was met with artillery fire from Syrian forces. The United Nations resolution that followed blocked Israel from continuing the construction, due to the veto of the USSR.⁹⁷ Construction then shifted to tap water from the Sea of Galilee. Today, the National Water Carrier supplies about 1.5 billion cubic meters of water annually, serving about 7 million end users. In addition to providing water for Israelis, Mekorot also provides water to the Palestinian Authority and to Jordan, tying water distribution to Israeli foreign policy.⁹⁸

The National Water Carrier succeeded in making productive agriculture possible in the Negev and improving quality of life in previously drought-prone areas. However, redistributing water did not solve the area's water troubles. With limited freshwater sources, scarcity continued to be a perennial issue. Beginning with a cabinet decision in 2000, the country has built

⁹⁵ "The Water Law of 1959." Israel Ministry of Foreign Affairs. Last modified December 22, 1998. <https://mfa.gov.il/mfa/pressroom/1998/pages/the%20water%20law%20of%201959.aspx>.

⁹⁶ Sitton, Dov, Dr. "FOCUS on Israel: Development of Limited Water Resources-Historical and Technological Aspects."

⁹⁷ Neff, Donald. "Israel-Syria: Conflict at the Jordan River, 1949-1967." *Journal of Palestine Studies* 23, no. 4 (1994): 26-40. <https://doi.org/10.2307/2538209>.

⁹⁸ "General Information." Mekorot: Israel National Water Co. <http://www.mekorot.co.il/Eng/newsite/AboutUs/Pages/GeneralInformation.aspx>.

numerous desalination plants, primarily in the south of the country.⁹⁹ Unlike Mekorot, most of these plants have been developed through public-private-partnerships between the government and entrepreneurs.

While Mekorot has continued to emphasize that desalination is not a perfect solution and that water conservation is still critical, desalination has been critical in meeting Israel's water needs.¹⁰⁰ Today, nearly 70% of Israeli drinking water is from desalination plants.¹⁰¹ The introduction of desalination has reduced the need for water to be pumped north to south from the Sea of Galilee. In fact, Mekorot stopped pumping water from the sea in 2013.¹⁰² Recently, a historic drought in Israel's north has incited Mekorot to change the direction of the National Water Carrier, pumping from south to north. In 2017, more water evaporated from the Sea of Galilee than entered the body, a phenomenon that had not occurred in 97 years.¹⁰³ The dropping sea level prompted a plan to reverse the flow of the National Water Carrier, instead pumping water from desalination plants in the south into the Sea of Galilee in the north. The plan, costing around \$30 million, will effectively turn the Sea of Galilee into a freshwater reservoir.¹⁰⁴ The nature of the project, adapting water infrastructure to balancing variable natural conditions, reflects the coordination and efficiency of the Israeli system.

⁹⁹ "Background - Seawater Desalination in Israel." Israel Ministry of Finance. https://mof.gov.il/en/InternationalAffairs/InfrastructuresAndProjects/Projects/Pages/Background_DesalinationInIsrael.aspx.

¹⁰⁰ Lidman, Melanie. "Desalination isn't the magic bullet, Water Authority warns Israelis." *The Times of Israel*, June 5, 2018.

<https://www.timesofisrael.com/desalination-isnt-the-magic-bullet-water-authority-warns-israelis/>.

¹⁰¹ ———. "Plan to pump desalinated water to Sea of Galilee may open diplomatic floodgates." *The Times of Israel*, June 27, 2019.

<https://www.timesofisrael.com/plan-to-pump-desalinated-water-to-sea-of-galilee-may-open-diplomatic-floodgates/>.

¹⁰² Pileggi, Tamar, and Melanie Lidman. "Water flow into Sea of Galilee at lowest level in a century." *The Times of Israel*, June 4, 2017.

<https://www.timesofisrael.com/water-flow-into-sea-of-galilee-at-lowest-level-in-a-century/>.

¹⁰³ Ibid.

¹⁰⁴ Lidman, Melanie. "Plan to pump desalinated water to Sea of Galilee may open diplomatic floodgates."

Exhibit 5.¹⁰⁵



But the system that has been crucial to managing Israel's water needs may not remain government-owned forever. Picking up on his privatization plans articulated when he served as finance minister in the early 2000s, Benjamin Netanyahu put forward a new proposal to sell

¹⁰⁵ "Mekorot's Involvement in the Israeli Occupation." Who Profits: The Israeli Occupation Industry. Last modified December 2013. <https://whoprofits.org/flash-report/mekorots-involvement-in-the-israeli-occupation/>.

stakes in government-owned companies in 2014. The plan proposed selling a variety of government companies, including Israel Natural Gas Lines, Israel Post, Israel Military Industries, the port of Ashdod, the port of Haifa, Israel Aerospace Industries, Rafael Advanced Defense Systems, and Israel Electric Corporation, in addition to Mekorot. Altogether, the sales were expected to bring in \$4.1 billion over the course of the following three years, which would then go towards paying down the deficit.¹⁰⁶ The abrupt three-year timeline turned out to be overly ambitious, especially given how prolonged the privatization of Bezeq was. While the government did sell Israel Military Industries to Elbit Systems in 2018, three years after the targeted date, other privatizations lost momentum. At the end of the period, Mekorot, Rafael Advanced Defense Systems, and Israel Aerospace Industries, among others, remained in government hands.¹⁰⁷

As of 2017, the Government Corporation Authority started to pick back up on the plan, reportedly planning IPOs of minority stakes in five government companies: Israel Aerospace Industries, Mekorot, Israel Post, and the ports of Haifa and Ashdod. In accordance with the original plan, the IPOs will only sell up to 49% stakes of the companies, retaining majority control to preserve the state's long-term interest.¹⁰⁸ In the case of Bezeq, the state had no long-term interest in controlling telecommunications networks. In that market, fully privatizing the former state monopoly eventually did lead to lower prices for consumers, even if the halting privatization process itself allowed the company to hold on to market power for longer than it

¹⁰⁶ Cohen, Tova, and Steven Scheer. "Israel approves \$4 billion privatization plan for next three years." *Reuters*.<https://www.reuters.com/article/us-israel-privatisation/israel-approves-4-billion-privatization-plan-for-next-three-years-idUSKCN0HU0RA20141005>.

¹⁰⁷ Coren, Ora. "IPOs Slated for Five Israeli Government-owned Companies." *Haaretz*, February 6, 2018. <https://www.haaretz.com/israel-news/business/ipos-slated-for-five-israeli-government-owned-companies-1.5790974>

¹⁰⁸ Ibid.

should have. However, full privatization in the case of Mekorot would not be prudent given that water is fundamentally a national security issue.

Water conflict in the region began to escalate in the 1950s, when nations bordering the Jordan River Valley began diverting its water to meet their populations' needs. In 1951, Jordan announced a plan to divert part of the Yarmouk River, the largest tributary of the Jordan River, in order to irrigate the East Ghor region. Two years later, Israel began construction on the National Water Carrier. Armed skirmishes at construction sites in both nations attracted international attention, leading President Eisenhower's special envoy Eric Johnston to draft the 1955 Johnston Plan. The plan allocated water from the Jordan River to the interested nations, directing that 55% should be allocated to Jordan, 36% to Israel, and 9% to each Syria and Lebanon. Arab states swiftly rejected the proposal; the United States' continued economic and military aid to Israel since 1948 had undermined its credibility as a neutral third party. A United Nations resolution ruled against Israel, shifting the construction of the National Water Carrier to the Sea of Galilee, which also borders Syria.

The completion of the National Water Carrier led to the Arab Summit in 1964, the first meeting of the Arab League. In response to the Israeli water carrier, the League devised the Headwater Diversion Plan, which would divert two of the three sources of the Jordan River, the Hasbani and the Banias, to prevent them flowing into the Sea of Galilee. Israeli forces attacked the new construction in Syria in a series of conflicts that would contribute to another Arab-Israeli war in 1967. Indeed, in the aftermath of the war, in addition to taking control of the Golan Heights, West Bank, and Gaza Strip, Israel destroyed the Syrian diversion project. Only two years later, in 1969, Israel attacked the Jordanian East Ghor Canal over suspicions that Jordan

was diverting more than its share of water. This time, both nations agreed to abide by the 1955 Johnston Plan and received American water aid.¹⁰⁹

While conflict between the Arab League and Israel have mellowed, water rights continue to be a significant political and ethical issue for Palestinian-Israeli relations. Following 1967, Israel either confiscated or destroyed the majority of Palestinian irrigation pumps on the Jordan River. While Israeli settlers drilled new irrigation wells as they moved into the occupied territories, Palestinian farmers were forbidden from drilling their own wells.¹¹⁰ It was not until the second Oslo Accords in 1995 that Palestinian water rights were even recognized. Oslo II established the Joint Water Commission to supervise water distribution, with Mekorot delivering water to the Palestinian Authority, which is responsible for distribution through its own networks.¹¹¹

Water diplomacy in Palestine

For Israel, water policy has become more than an issue of supporting the nation's own population. Scholars have made the argument that Mekorot has intentionally drilled new wells in order to deplete Palestinian water resources, forcing Palestinians to rely on Israeli water infrastructure. Since 1968, Mekorot has drilled at least fourteen new wells in the West Bank in order to provide water to Israeli settlements in the occupied territories. While Israeli settlements have been declared illegal by the United Nations General Assembly, United Nations Security

¹⁰⁹ United Nations. "Israel: International Water Issues." Food and Agriculture Organization of the United Nations. http://www.fao.org/nr/water/aquastat/countries_regions/Profile_segments/ISR-Intlss_eng.stm.

¹¹⁰ Ibid.

¹¹¹ Gvirtzman, Haim. "Israeli-Palestinian Water Agreements." In *The Israeli-Palestinian Water Conflict: An Israeli Perspective*, 4-11. N.p.: Begin-Sadat Center for Strategic Studies, 2012. <http://www.jstor.org/stable/resrep04739.5>.

Council, and International Court of Justice, having Mekorot, a government-company, create the infrastructure to support them is in effect tacit state-approval.¹¹² Moreover, these wells have been located such that they deplete water sources that would have otherwise gone to Palestinian wells. While Palestinian villages are given access to Mekorot's infrastructure, by accepting, they cede their independence. If Palestinians are dependent on Israel for something as fundamental as water, their ability to survive as a separate community—let alone separate nation—is undermined. Perhaps even more importantly, if they do not control the water, they cannot cultivate or control the land.¹¹³

The geographic realities of the Middle East mean that water scarcity will always be a prominent geopolitical issue for every state in the region. Israel, primarily through Mekorot, has crafted water policy and infrastructure to manage its water consumption in a sustainable way. Given Mekorot's expansive network of water infrastructure that supplies Israel as well as parts of the occupied territories and Jordan, the government-company's trajectory will continue to be tied to Israel's political ambitions in the region. When weighing the tradeoffs between public sector and private sector risk for Mekorot, long-term national security and foreign policy concerns must be tantamount. Through the sale of a minority stake, the government can generate a substantial cash inflow and reduce the burden of financing the company while continuing to control its operations and vision. In developing infrastructure for a resource as politically sensitive as water is in Israel, the state must protect its role as the decision-maker.

¹¹²Kershner, Isabel. "Are West Bank Settlements Illegal? Who Decides?" *The New York Times*. <https://www.nytimes.com/2019/11/18/world/middleeast/israel-west-bank-settlements.html>.

¹¹³ "The West Bank's Water." *Journal of Palestine Studies* 7, no. 4 (1978): 175-79. <https://doi.org/10.2307/2536311>.

Desalination Plants – Utilizing public-private partnerships

"There are two factors here: one is God, who brings whatever rain he does. In the last few years he's been a little disappointing. The other is whatever water sources we can develop ourselves."

– Uri Saguey, Former Chairman of Mekorot¹¹⁴

Born out of necessity, Israel's desalination program is perhaps the most robust in the world. In developing it through public-private partnerships, the state leveraged the expertise of the private sector while effectively shifting all short-term risk to private companies. The country's desalination plants have been structured to incentivize efficiency while still providing Israel with the water output it needs.

A natural crisis

Since its inception, Israel has always been acutely aware of water distress. The country ranks 10th in the lowest levels of renewable freshwater resources per capita, severely constricting its ability to tap its national resources¹¹⁵. Historically, necessity has prompted innovation, as seen with the National Water Carrier, which successfully hydrated water-poor regions. The country's water recycling infrastructure has been similarly effective: 86% of wastewater is reused for irrigation. In context, Spain, the second-most wastewater efficient

¹¹⁴Orme, William A., Jr. "Israel Raises Its Glass To Desalination; Water, Water Everywhere Just Waiting For Price to Drop." *The New York Times*, June 23, 2001, International Business. <https://www.nytimes.com/2001/06/23/business/international-business-israel-raises-its-glass-desalination-water-water.html>.

¹¹⁵ "Renewable internal freshwater resources per capita (cubic meters)." The World Bank. https://data.worldbank.org/indicator/er.h2o.intr.pc?most_recent_value_desc=false.

country in the world, recycles just 19% of its wastewater.¹¹⁶ But even after optimizing for distribution and recycling, Israel still found itself falling nearly half a billion cubic meters short of its annual freshwater needs.¹¹⁷

The situation became particularly precarious in the early 2000s, when a series of droughts lowered the water level of the Sea of Galilee. Desalination appeared to be the best path forward: in 2000 a cabinet decision authorized desalination plants, and five years later the first plant was completed in Ashkelon. As of 2018, nearly 585 million cubic meters of water are desalinated annually in Israel. The five plants contribute in the following amounts:

*Exhibit 6.*¹¹⁸

Plant	Annual Output (million cubic meters)
Soreq	150
Hadera	127
Ashkelon	118
Ashdod	100
Palmachim	90

All five plants use the reverse osmosis method of desalination. The traditional evaporation process evaporates seawater and passes it through a series of chambers, leaving behind salt in each stage. The vapor is then condensed, resulting in desalinated water. Evaporating water takes a great deal of energy, making it infeasible in regions with high energy costs. The reverse osmosis method passes seawater through a semipermeable membrane that

¹¹⁶ Jacobsen, Rowan. "Israel Proves the Desalination Era Is Here." *Scientific American*. Last modified July 29, 2016. <https://www.scientificamerican.com/article/israel-proves-the-desalination-era-is-here/>.

¹¹⁷ *Ibid.*

¹¹⁸ "Background - Seawater Desalination in Israel." Israel Ministry of Finance.

prevents salt from passing through. The use of a membrane rather than multiple state changes makes the process much less expensive.¹¹⁹

Risk transfer to the private sector

The success of these desalination plants in tiding over Israel's water needs is in part due to the financing and ownership decisions made in their development. By tapping private sector expertise while maintaining government oversight through public-private partnerships, the Israeli model of financing desalination plants has incentivized operational efficiency while maintaining quality standards and reliable output volumes.

All of the plants were financed and developed through public-private partnerships, cooperative structures between the private sector and the government designed to limit each participant's risk exposure. With the exception of the Palmachim plant, which was developed through the build-operate-own (BOO) method, Israel's desalination plants were developed through build-operate-transfer (BOT) plans (*Exhibit 6*). For the BOT plants, the government auctions a concession to a contractor who then builds and operates the plant for the next 25 years. Over this time period, the concessionaire sells output to the government, making back its initial investment. At the end of the period, the ownership of the plant transfers to the government. Under the BOO model, the private company retains ownership of the asset following the concession term.

¹¹⁹ Ibid.

Exhibit 6.

Overview of Desalination Plant Concession Terms¹²⁰

Plant	Start of Operations	Concession Term	Concessionaire	Shareholders
Soreq	Q3 2013	Shorter of 5/19/2037 or 24 years and 11 months from start	Sorek Desalination Ltd.	IDE Technologies Ltd. (100%)
Hadera	Q4 2009: Initial commission of 100 mcm per annum Q3 2010: Additional commission of 27 mcm per annum	24 years and 11 months	H2ID Ltd.	IDE Technologies Ltd. (50%) Shikun & Binui (50%)
Ashkelon	Q3 2005: Initial commission of 100 mcm per annum Q4 2010: Additional commission of 18 mcm per annum	24 years and 11 months	VID Desalination Ltd.	IDE Technologies Ltd. (50%) Veridis (50%)
Ashdod	Q4 2015	Shorter of 12/8/2038 or 24 years and 11 months from start	Ashdod Desalination Ltd.	Mekorot Development and Initiation (100%)
Palmachim	Q2 2007: Initial commission of 30 mcm per annum Q3 2010: Additional commission of 45 mcm per annum Q1 2013: Additional commission of 15 mcm per annum	24 years and 11 months	Via Maris Desalination Ltd.	Israel Infrastructure Fund (100%)

For the government, the primary attraction of these projects is that they push the risk of the project almost entirely to the private sector while still gaining access to desalinated water. Without private sector participation, the state would have to build, finance, and operate the plant on its own, taking on the risks of financial and operational failures. Getting a private company to

¹²⁰ The State of Israel. "Background - Seawater Desalination in Israel." Ministry of Finance.

develop the asset eliminates these risks. As these concessionaires undertake massive greenfield projects, the required construction, equipment, and labor expenditures stimulate economic growth, all without increasing the government's short term deficit.¹²¹ Moreover, by involving the private sector, these projects could build on the concessionaire's previous operating knowledge, which would be faster and more efficient than a government agency starting from scratch. For instance, by the time the Ashkelon plant was commissioned, one of its shareholders, IDE Technologies, had already commissioned the Gujarat Reliance Project in India (1998) and the Sarlux desalination plant in Italy (1999).¹²² Leveraging such knowledge was especially critical given that the success or failure of desalination would have very real consequences for Israel's water security. By utilizing public-private partnerships, the government becomes the buyer of a resource rather than the seller and operator.

On the other hand, the concessionaire makes the tradeoff between significant upfront capital expenditures and a guaranteed stream of income. In addition to building the plant, the concessionaire arranges its financing, operations, and maintenance. In exchange for taking on all these risks, concessionaires are guaranteed payments for the life of the contract term from the government, or in the case of Israel, Mekorot, a government company. The construction costs of these projects are typically financed 80% through debt, with the remaining 20% coming from the equity stake of the concessionaire. As such, the concessionaire is at the bottom of the capital structure. This structure incentivizes lenders to monitor the practices of the concessionaire and the

¹²¹ OECD-WWC-Netherlands Roundtable on Financing Water. *Attracting Private Funding through Public Finance: A Case Study of Desalination of Sea Water in Israel*. By Yitsik Marmelshtein. 2017. [https://www.oecd.org/env/resources/Marmelshtein%20\(2017\)%20Attracting%20private%20funding%20--%20desalination%20Israel.pdf](https://www.oecd.org/env/resources/Marmelshtein%20(2017)%20Attracting%20private%20funding%20--%20desalination%20Israel.pdf).

¹²² "Our Projects." IDE Technologies. <https://www.ide-tech.com/en/our-projects/>.

project since repayment of the debt depends on the project's success. It also incentivizes the concessionaire to operate as efficiently as possible, since the equity payout will be last.¹²³

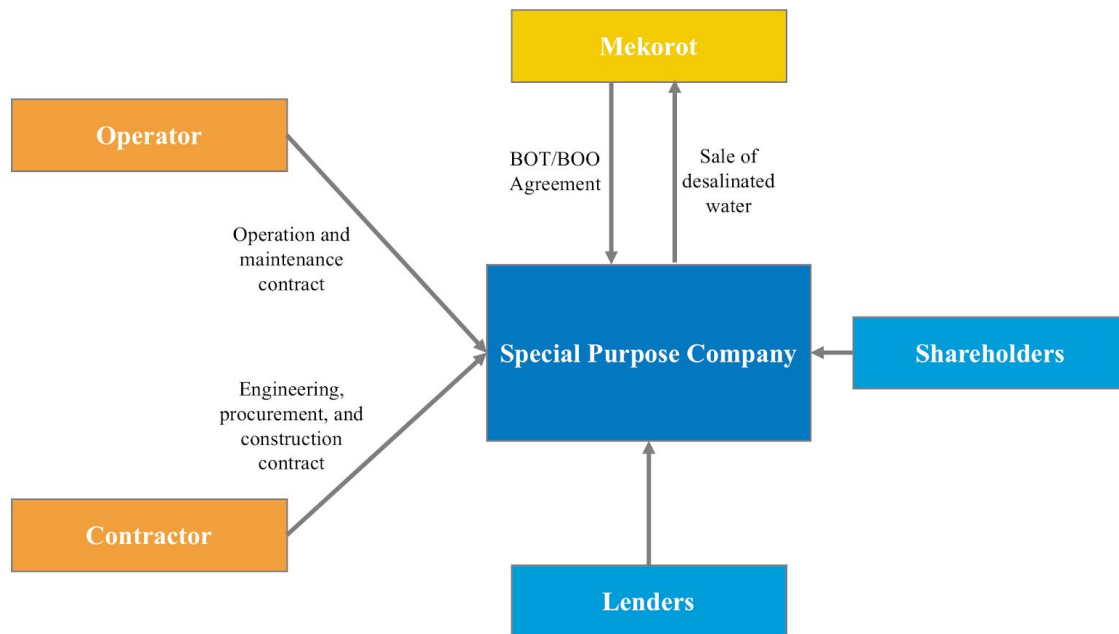
Still, the model is not perfect. For one, the transaction costs associated with running a process to select a concessionaire and writing an effective contract would not be present if the public sector developed the plants itself. Moreover, by contracting out the plants, the state is effectively ceding control over crucial public infrastructure. While Mekorot is still involved in overseeing the concessionaire's output during the concession period, leaving huge volumes of water supply to the private sector is still a risk. Left in private hands, the project also faces higher funding costs since a private company will not be able to borrow at rates as low as the government would be able to.

Structurally, desalination plants are organized as special purpose companies, with which each involved party then contracts with (*Exhibit 7*). The tender process typically takes one year, during which qualified bidders are identified and then evaluated. Following the selection of a bidder, it takes another year to determine the financing structure of the project and reach a financial close. Construction of the plant itself takes between two to three years, with construction work either contracted out to external parties or completed by the concessionaire itself. After construction has completed, the plant is evaluated and receives a Permit to Operate, after which it may begin the desalination process. Throughout the period of the concession, Mekorot continually checks the concessionaire's compliance with the contract terms regarding quality and quantity of water output.¹²⁴

¹²³ OECD-WWC-Netherlands Roundtable on Financing Water. *Attracting Private Funding through Public Finance: A Case Study of Desalination of Sea Water in Israel*.

¹²⁴ Ibid.

Exhibit 7.¹²⁵



While the five major desalination plants were built through public-private partnerships, Mekorot operates thirty-one small desalination plants, primarily in the south of the country.¹²⁶ Altogether, the desalination system in Israel has provided the country with reliable water output in a region where water is heavily politicized and rainfall from year to year is unreliable. The use of public-private partnerships has contributed to the success of desalination. By creating structures that align financial incentives, the public-private partnership model tapped into the innovation and expertise of private enterprise. These large-scale projects stimulated the economy without driving up a short-term deficit. Most importantly, the state secured water resources while reducing its exposure to financial and operational risks.

¹²⁵ IDE Technologies. "PPP Contractual Structure." Chart. June 24, 2008. https://wrrc.arizona.edu/sites/wrrc.arizona.edu/files/programs/conf2008/presentations/Michael_Tramer-June-2008.pdf.

¹²⁶ Garb, Yaakov. "Desalination in Israel:." In *Water Wisdom: Preparing the Groundwork for Cooperative and Sustainable Water Management in the Middle East*, by Alon Tal and Alfred Abed Rabbo, 238-45. N.p.: Rutgers University Press, 2010. <http://www.jstor.org/stable/j.ctt5hj11w.36>.

Israel and the Neoliberal State

For an ideology once lauded as part of the ultimate destiny of mankind, neoliberalism has an imperfect legacy. In 2016, the International Monetary Fund itself admitted to the failings of the economic principles for which it had so ardently advocated. While economic neoliberalism succeeded in lifting millions out of poverty and increasing foreign investment and knowledge transfer, its failings should not be ignored. Most notably, (1) it is hard to establish a consistent pattern of economic improvement across all countries where policies were implemented, (2) neoliberal policies often achieved growth at the expense of increased inequality, and (3) the resulting inequality in turn stymies sustainable growth.¹²⁷

In Israel as well, inequalities have resulted. Discontent with the exorbitant cost of living led to mass protests in 2011, culminating in 400,000 Israelis demonstrating in Tel Aviv.¹²⁸ Protestors were mostly middle-class Israelis, who carry a disproportionate burden in regards to labor force participation, military service, and tax payments. More generally, the high cost of living is a symptom of an economic system hampered by concentration on the part of both companies and individuals, an example of what imperfectly implemented neoliberalism can do. In response to the protests, the economy became a dominant issue of Israeli politics. Since 2011, the situation has improved, with real wages up 6% in 2015. However, these changes may have more to do with depressed oil prices than systematic improvements.^{129,130}

¹²⁷ Ostry, Jonathan D., Prakash Loungani, and Davide Furceri. "Neoliberalism: Oversold?"

¹²⁸ Kershner, Isabel. "Summer of Protest in Israel Peaks With 400,000 in City Streets." *The New York Times*, September 3, 2011. <https://www.nytimes.com/2011/09/04/world/middleeast/04israel.html>.

¹²⁹ Bahar, Dany. "Five years after the social protests in Israel, what has changed?" The Brookings Institution. Last modified August 1, 2016. <https://www.brookings.edu/blog/markaz/2016/08/01/five-years-after-the-social-protests-in-israel-what-has-changed/>.

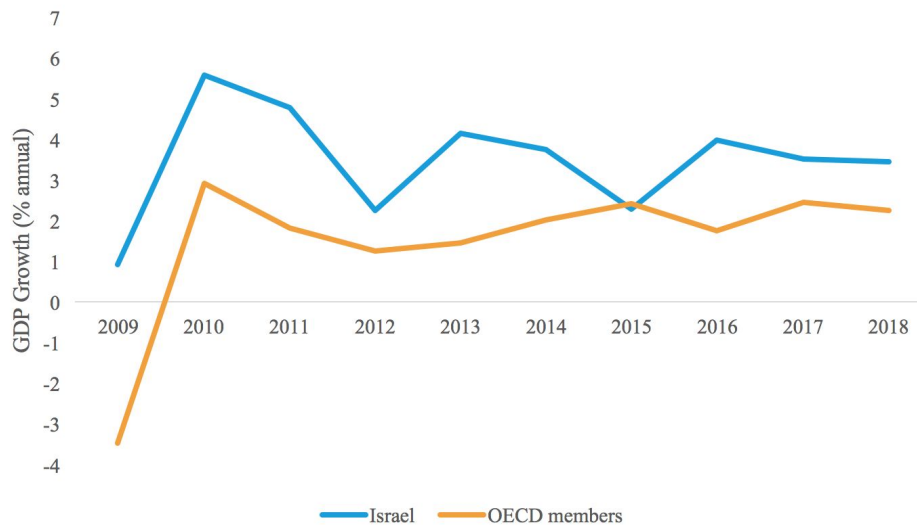
Even if Israelis are experiencing the pitfalls of inequality now, Israel as a whole has undoubtedly benefited from economic growth following the 1985 Stabilization Program. In academic literature and the voting booth, Israel's turn toward economic liberalization is usually considered a success. Academic articles often extol the Israeli stabilization plan as an example of triumph in the face of hyperinflation. The Brookings Institution lauds Shimon Peres, who oversaw the Economic Stabilization Program as the 'savior of the Israeli economy'.¹³¹ Other academics describe the program as a "a rare case of stable success under democratic auspices without major social disorder".¹³² Israelis today continue to benefit from the path the program set for the country. For voters, continuing that economic prosperity is one of the most pressing political issues. Neoliberal policies truly intensified under Benjamin Netanyahu, who as Finance Minister and later as Prime Minister pushed policies to reduce the role of the public sector by (1) privatizing state assets and (2) cutting subsidies and welfare programs. Since he took office in 2009, Israel has seen consistent GDP growth, generally at a rate above the OECD average (*Exhibit 8*).

¹³⁰ Changes in real wages are calculated by finding the differences between nominal wages and prices. Since global oil prices have been depressed, the rise in real wages may have more to do with falling overall prices, weighed down by oil, than with improvements in purchasing power.

¹³¹ Bahar, Dany. "How Shimon Peres saved the Israeli economy."

¹³² Reuveny, Rafael. "Democracy, Credibility, and Sound Economics: The Israeli Hyperinflation." *Policy Sciences* 30, no. 2 (1997): 91-111. Accessed January 14, 2020. www.jstor.org/stable/4532401.

Exhibit 8.¹³³



The wealth created by Netanyahu's policy decisions has uplifted the Israeli economy as a whole, even if it has been distributed unequally. For many Israelis, even those who object to Likud's stances on national security and religion, Netanyahu's economic track record looks like a winning bet.¹³⁴ The allure of continued economic prosperity is so strong that even after multiple indictments on corruption charges for Netanyahu, Likud finished with the most seats in the March 2020 elections.¹³⁵ Academic praise for Israel's economic liberalization seems to reflect the reality on the ground: neoliberal policies set Israel on a rosier path than the one it was facing in the 1980s. This is certainly true in the case of infrastructure. By approaching infrastructure

¹³³ "GDP growth (annual %)." The World Bank.
<https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>.

¹³⁴ Srivastava, Mehul. "Israelis learn to stomach Netanyahu as a solid economy lifts spirits." *Financial Times*, April 2, 2019. <https://www.ft.com/content/6e3c7c90-54bd-11e9-91f9-b6515a54c5b1>.

¹³⁵ *Haaretz*. "Final Election Results: Netanyahu Bloc Short of Majority With 58 Seats." March 6, 2020. <https://www.haaretz.com/israel-news/elections/.premium-israel-election-2020-netanyahu-gantz-1.8627591>.

privatization through different methods, Israel reduced the state's financial burden while preserving its long-term interests.

Of the cases studied in this paper, Bezeq is the least successful. In that case, the failure of neoliberalism was not in ideology but in application. By the time Israel was looking at selling Bezeq, beginning in the mid-1990s, it was clear that the government's ownership of the company in the near-term was not necessary to meet the long-term objective of reliable telecommunications services. The private sector had developed enterprises capable of bridging the gap that had once existed. In most of Bezeq's subsegments, the state began to disentangle itself, granting licenses to competitors in international communications, cellular communications, and multi-channel television. But the lucrative domestic telephony monopoly was not broken until after the company had begun its privatization process, leaving a dominant company in private hands. The decision to privatize was aligned with the new reality of the telecommunications market. However, incomplete privatization left barriers in place, leading to concentration.

In the case of Mekorot, the state maintained its control over Israel's water supply to meet the dual goals of (1) serving the population's needs and (2) supporting claims to geopolitically critical freshwater resources. In the pre-state community, control of water supplies was critical to settling across a wide geographical area and cultivating successful, self-sufficient agricultural communities. Developing and maintaining water infrastructure was critical to early state-building much in the same way that developing an army was. Today, decades after the major armed conflicts surrounding water in the region, water continues to be a major issue for Israel. As a government company, Mekorot is able to organize the entire nation's water needs at

scale, prioritizing access and coordination in a way that a collection of private companies trying to achieve the same goal would likely not be able to. As a result, Mekorot's water reclamation efforts and the construction of the National Water Carrier have made great strides in managing the scarce resource. Moreover, Mekorot's water prowess has been useful in navigating the politics of Palestinian relations. Mekorot itself was created on the principle that the nation must have independent access to a scarce resource if it hoped to survive among hostile neighbors. If work published in *The Journal of Palestine Studies* is correct, Mekorot seems to be applying the same logic to undermine Palestinian independence.¹³⁶

Because of the nation's geography, it has always been, and will always be, important for the state of Israel to maintain its control over the collection and distribution of water. The current proposal to privatize Mekorot would maintain a 51% ownership stake for the state. As long as a privatization plan maintains the state's decision-making authority, it should continue to be aligned with Israel's long-term interest.

With desalination plants, the long-term objective is the same: to ensure consistent freshwater supplies. In the short-term, however, as long as reliable output continues, the state has no clear interest in owning or operating the plants themselves. Public-private partnerships make sense in this context because they localize the private sector risk to a guaranteed payback period while meeting the criteria of the state: reliable output in the short-term and possession in the long-term.

Globally, neoliberal economic policy has a mixed reputation, at best. Even within Israel, its results are not perfect. Privatization and a shrinking public sector have achieved economic

¹³⁶ "The West Bank's Water." *Journal of Palestine Studies* 7, no. 4 (1978): 175-79.

growth at the expense of social services and income equity. Nevertheless, Israelis today still seem to buy into the economic vision first articulated in 1985. Economic growth since stabilization has seen the country prosper and has raised the standard of living far above what early settlers could have imagined. Today, critiques of neoliberal theorists and their policy recommendations abound. In the Israeli case, those theorists may find some vindication.

Appendix: Applicability of the Israeli Case to the United States

Collectivism versus individualism

If a similar story were told for the United States, it would unfold very differently. Early in Israel's history, the ability to centralize was a key driver of success in establishing and securing the community. A powerful government was necessary to organize political, logistical, and military efforts for the survival of the population. In the United States, on the other hand, founders were deeply opposed to strong centralization. Founding documents such as the US Constitution and Bill of Rights emphasize individual rights. Culturally, individualism is foundational to American identity. This idea was in part responsible for the country's early approach to infrastructure. From the start, private investment was a significant contributor to national development.

Telecommunications: regulation through prosecution

In telecommunications, the United States government managed public risk through regulation rather than ownership. From Alexander Graham Bell's telephone patent in 1876 to a powerful antitrust suit in 1983, the Bell Company, which would become American Telegraph &

Telephone (AT&T) in 1885, dominated American telecommunications. The Department of Justice took its first swing at the monopoly in 1913 with an antitrust suit. At the time, Congress had toyed with the idea of nationalizing the telephone network in the public interest. Ultimately, however, AT&T settled with prosecutors, agreeing to the Kingsbury Commitment. In the settlement, AT&T agreed to let independent local telephone companies connect to its long distance network and promised not to complete acquisitions opposed by the Interstate Commerce Commission.¹³⁷ The Kingsbury Commitment was a seminal manifestation of the American attitude towards infrastructure development: it aimed to maintain widespread, equitable access for Americans while leaving the operations to the private sector.

Still, AT&T and the Bell System dominated the marketplace. Local operators bought telephones and related equipment from Western Electric, a wholly owned subsidiary of AT&T, which dominated 90% of the market. In addition, the operators paid licensing fees to Bell Laboratories, the company's research and development arm.¹³⁸ Through this vertically integrated model, AT&T still effectively operated a monopoly. By 1956, AT&T was the largest privately-held company in the world: it owned 98% of long-distance telephone services facilities and 85% of short-distance telephone services facilities.¹³⁹ Aside from market competition, the company's scale and influence prompted another concern for regulators. Bell Labs had been an indispensable contributor to American scientific knowledge. In addition to developments in telephony terminals, transmission, and operations, innovation at Bell Labs had led to inventions

¹³⁷Griffin, Jodie. "100th Anniversary of the Kingsbury Commitment." Public Knowledge. Last modified December 19, 2013. <https://www.publicknowledge.org/blog/100th-anniversary-of-the-kingsbury-commitment/>.

¹³⁸ Watzinger, Martin, Thomas A. Fackler, Markus Nagler, and Monika Schnitzer. "How antitrust enforcement can spur innovation: Bell Labs and the 1956 consent decree." *American Economic Journal*. https://economics.yale.edu/sites/default/files/how_antitrust_enforcement.pdf.

¹³⁹ Ibid.

such as the transistor, information theory, laser, solar cell, and fiber-optic communications.¹⁴⁰

The risk of one company potentially hoarding new knowledge of was deeply problematic. The government's antitrust suit in 1956 was aimed at these perceived inequities and was settled through consent decrees. These agreements mandated that Bell license lower its royalty fees of 1%-6% on patents to zero and make licenses available to interested parties without a bargaining process.¹⁴¹

Despite the punitive consent decrees, AT&T continued to display anticompetitive behavior throughout the 1960s and 1970s. Finally, the government decided that the company was too large to effectively regulate. In 1983, regulators broke up the Bell System by breaking up AT&T. Bell Labs and Western Electric remained under the AT&T umbrella while the regional Bell operating companies and providers of local phone service formed a new company, Bellcore.

The United States has allowed private enterprise and innovation to drive its telecommunications sector. In that sense, it has never had to deal with the privatization of a public monopoly like Israel did with Bezeq. But despite their differences in ownership, Bezeq and AT&T acted in similar ways. At different points in time, both companies were monopolies in their respective markets that used anticompetitive practices to cling to market power even as their government tried to open their markets to competition. In policing these markets, each government had to continually evaluate the public interest it was protecting.

As a network-based industry, telecommunications requires high capital expenditures, creating huge barriers to entry. Armed with scale, the incumbent quickly gains the advantage,

¹⁴⁰ National Research Council. "Renewing U.S. Telecommunications Research." *The National Academies Press*, 2006. <https://doi.org/10.17226/11711>.

¹⁴¹ Watzinger, Martin, Thomas A. Fackler, Markus Nagler, and Monika Schnitzer. "How antitrust enforcement can spur innovation: Bell Labs and the 1956 consent decree."

even if it does not provide the best service or most competitive prices.¹⁴² Both AT&T and Bezeq illustrate this. Unlike Bezeq, AT&T's monopoly was not mandated by the government, but its ability to scale early crushed competitors' chances. In Israel, once Bezeq's monopolies were broken by regulation, prices fell dramatically. Under this industry dynamic, an unregulated market, as in the United States, as well as a government-mandated monopoly will undercut competition.

Water: decentralized organization

American water infrastructure, like telecommunications, developed in a decentralized way, with municipalities making their own decisions regarding privatization. In addition to a cultural attitude inherently skeptical of large, centralized authority, the American system had other distinctions that led it down a different path than Mekorot in Israel. For one, water does not carry the same degree of political importance in the United States as it does in Israel. Land area is an obvious factor: the United States has 8,851 renewable internal freshwater resources per capita in cubic meters compared to Israel's 91.¹⁴³ Moreover, the United States does not compete heavily with its neighbors for shared resources the way Israel does. Given the United States' relative size—over 400 times larger than Israel in terms of land area—it would likely not be feasible or efficient to build and maintain a central water infrastructure system.

As colonists arrived in North America, various communities made their own decisions about how to build water infrastructure. In 1772, Rhode Island contracted two private water

¹⁴² Dichter, Alex, Ekaterina Khvatova, and Corrado Sala. "Sizing the advantages of incumbency." McKinsey & Company. Last modified October 2012. <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/sizing-the-advantages-of-incumbency>.

¹⁴³ "Renewable internal freshwater resources per capita (cubic meters)." The World Bank.

delivery companies for its supplies. New York used private wells as its main water source and eventually established a private water company, the Manhattan Company, to organize the city's water needs. By the middle of the 19th century, 50 of the country's 83 water systems were privately owned. By the end of the century, the country had over 3,000 systems, half of which were privately owned.¹⁴⁴

The trend towards decentralization increased as the country's population expanded westward. Today, there are 148,000 public water systems that together serve 90% of Americans.

¹⁴⁵ These systems can be either publicly owned by a municipality/city or privately owned by a company. The diversity of climates and political environments these water systems exist in has resulted in various levels of quality, with many systems still using pipes from the 1800s.¹⁴⁶

Overall, the American Society of Civil Engineers has awarded drinking water infrastructure in the United States grades varying between D-minus and D for over a decade. By the Society's estimates, \$1 trillion in investment will be needed to service drinking water demand over the next 25 years.¹⁴⁷ As this money is raised and spent, it is critical to think about how projects should balance public and private risk going forward. In doing so, the Israeli model could hold powerful lessons.

¹⁴⁴ "History of US Water and Wastewater Systems." In *Privatization of Water Services in the United States: An Assessment of Issues and Experience*, 29-40. The National Academies Press, 2002.
<https://www.nap.edu/read/10135/chapter/4>.

¹⁴⁵ "Drinking Water Requirements for States and Public Water Systems." United States Environmental Protection Agency. <https://www.epa.gov/dwreginfo/information-about-public-water-systems>.

¹⁴⁶ "How Development of America's Water Infrastructure Has Lurched through History." The PEW Charitable Trusts. Last modified March 3, 2019.
<https://www.pewtrusts.org/en/trend/archive/spring-2019/how-development-of-americas-water-infrastructure-has-lurched-through-history>.

¹⁴⁷ American Society of Civil Engineers. 2017 Infrastructure Report Card. Last modified 2017.
<https://www.infrastructurereportcard.org/>.

While it is not feasible or necessary to apply a nationally centralized system like Mekorot's to the United States, Israel's management of desalination plants may provide a useful framework for involving the private sector in water infrastructure. Currently, American water systems have employed privatization unevenly, with mixed results. Studies have found that investor-owned utilities typically charge 59% more for water service and 63% more for sewage service than local government utilities.¹⁴⁸ In these cases there appears to be a mismatch in the public's long-term interest and the short-term application of policy. While these private owners are providing citizens clean and reliable drinking water, it is not clear that they are the most efficient vehicle to do so. A better model might mimic the public-private partnerships utilized by Israel, whereby the local government contracts with a private enterprise for water treatment. This model would still leverage private sector innovation, but could modulate rates since the authority in charge of price setting would not be motivated by profit maximization.

The future of infrastructure spending

The next decade will be transformative for infrastructure globally. In the United States, the recent coronavirus pandemic will likely accelerate the speed and scale of federal infrastructure spending. In March of 2020, President Donald Trump expressed enthusiasm for infrastructure spending, especially in light of near-zero interest rates, calling for up to two trillion in investment.¹⁴⁹ New infrastructure spending would act as a stimulus, which, in addition to other

¹⁴⁸ "Water Privatization: Facts and Figures." Food & Water Watch. Last modified August 31, 2015. <https://www.foodandwaterwatch.org/insight/water-privatization-facts-and-figures>.

¹⁴⁹ Samuels, Brett. "Trump backs infrastructure bill as next phase of coronavirus relief." The Hill. Last modified March 31, 2020. <https://thehill.com/homenews/administration/490353-trump-backs-infrastructure-bill-as-next-phase-of-coronavirus-relief>.

packages such as Coronavirus Aid, Relief, and Economic Security (CARES) Act, might help revive a stalled economy once the pandemic is under control. Calls for infrastructure spending will likely win bipartisan support: “nation-building” carries political points for both parties. Speaker Nancy Pelosi and House Democrats have revived a \$760 billion bill introduced in January that would include money for highways, bridges, alternative vehicle charging stations, airports, wastewater, broadband, community health centers.¹⁵⁰ Concurrently, private infrastructure investment has gained tremendous traction in recent years, with infrastructure funds raising a record-breaking \$104 billion in 2018 followed by \$97.3 billion in 2019.¹⁵¹

As both public and private funds are deployed in the coming years, governments will inevitably have to consider the role of private enterprise in the operations of infrastructure assets the public depends upon. In Israel, as globally, privatizing core infrastructure requires a rigorous evaluation of industry dynamics and the state’s own long-term interests.

¹⁵⁰ Wehrman, Jessica. "Pelosi revives ambitious infrastructure bill for next stimulus." Roll Call. Last modified April 1, 2020.

<https://www.rollcall.com/2020/04/01/pelosi-revives-ambitious-infrastructure-bill-for-next-stimulus/>.

¹⁵¹ Infrastructure Investor, comp. *2019 Fundraising Report*. January 21, 2020.
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<https://www.reuters.com/article/us-israel-privatisation/israel-approves-4-billion-privatization-plan-for-next-three-years-idUSKCN0HU0RA20141005>.
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